C.D. Howe Institute

Summary

Evaluating the Free Trade Deal:

A Guided Tour through the Canada-U.S. Agreement

by

Richard G. Lipsey and Robert C. York

The final text of the Canada-U.S. Free Trade Agreement has been available since December 1987. Supporters and opponents of the Agreement recognize that it is an historic document. Accepting or rejecting it will have both real and symbolic effects that will persist for decades, possibly for centuries.

During the debate over the Agreement, a staggering number of errors of fact and interpretation have been published. It is difficult for the public to develop an informed opinion about the Agreement when so many different versions of its contents are being circulated. Few Canadians can be expected to read the Agreement, much less to penetrate the opaque language in which it is sometimes couched. Furthermore, the language of the Agreement is often copied from that of the General Agreement on Tariffs and Trade (GATT), and a knowledge of GATT rules and precedents is needed to appreciate the significance of many aspects of the Agreement's clauses.

The purpose of this study is to foster informed debate over the real content of the Agreement. The study places the Agreement in its

historical perspective and then provides a brief overview of its contents to show what it provides by way of access to the U.S. market. It then goes through the Agreement a second time, chapter by chapter, using three main headings: the *content* of the chapter, its *significance,* and questions and responses relating to *concerns* that are relevant to the chapter.

Readers who have followed the debate may be surprised to find that the Agreement leaves Canada free to maintain and pursue its own distinctive policies in all of the important areas that go to the heart of nationhood.

The Agreement in Historical Context

For almost 60 years, Canada's infant industries developed behind the high tariff walls set up by the National Policy of 1879. Then, in the 1930s, two sets of pressures helped to shift Canadian trade policy toward an outward-looking stance. First, by this time, some Canadian manufacturing had passed the infant-industry stage and was ready to begin integration into the world trading economy. Second, the high tariffs the United States had recently established were harming both countries by restricting their mutually profitable trade.

As a result of these pressures, Canada signed two major trade-liberalizing agreements with the United States in the mid-1930s. Then, in 1947, Canada became a charter member of the GATT. This committed Canada to a policy of liberalizing its foreign trade, and confirmed its rejection of an inward-looking policy based on heavy protectionism.

Since the early 1970s, concern has grown over the GATT's ability to sustain world trade liberalization. Nonetheless, a new round of GATT negotiations, the Uruguay Round, is just getting under way. Its main objectives are to deal with nontariff barriers to trade, with trade in services, and with the distorting effects on world trade in agricultural goods that are caused by heavy domestic subsidization of agriculture in many countries, including both Canada and the United States.

The outcome of the Uruguay Round cannot yet be foreseen. Some observers remain optimistic that it will achieve significant gains; others fear that the GATT will be unable to maintain even the current degree of liberalized trade, let alone liberalize trade still further.

The bilateral agreements made in the 1930s with the United States and successive GATT rounds of tariff reductions have removed something like three-quarters of the Canadian trade barriers that were in place in 1935. Although this is an impressive result, and although much Canadian-U.S. trade now moves completely tariff free, remaining U.S. tariffs still exert a substantial restraining effect on Canadian exports to that country.

Today, Canadian policymakers worry much more about market access then they did earlier in the century. Until recent times, Canada's exports were mainly primary products. Because Canada was a major, and in some cases almost the only, supplier of these products, the world beat a path to Canada's door. Market access for Canadian exports was not then a serious issue. Today, international competition is fierce, and market access is now a key issue for Canadian exporters.

An Overview of the Agreement

Current Canadian policy is to pursue access to foreign markets on two main fronts: the Canada-U.S. Free Trade Agreement and the Uruguay Round of GATT negotiations. The Canada-U.S. Free Trade Agreement dismantles most of the existing restrictions on Canada's trade with the United States, its largest trading partner. This means that it comes close to completing the program, begun in 1935, of integrating the Canadian economy into the world trading system.

What is new in the present Agreement, compared with any liberalization of trade negotiated through the GATT, is that it covers only trade with the United States, not trade with all countries. This may well have political and symbolic consequences, and these are discussed in the text. However, since close to 80 percent of Canada's foreign trade is with the United States, it is hard to believe that the economic consequences of Canadian-U.S. trade liberalization will differ significantly from those of previous multilateral, GATT-negotiated, trade liberalizations, all of which were adopted without national debate and carried through without nationally noticed dislocation.

Main Characteristics of the Agreement

The study characterizes the Agreement in seven points:

It promotes free trade. The main theme of the Agreement is to establish, and to preserve, free trade between Canada and the United

States in virtually all manufactured goods, many agricultural goods, and a range of traded services.

It is GATT-like. The Agreement is founded mainly on the GATT and on GATT principles. Many clauses — including some of those that have come under severe criticism — merely repeat obligations Canada already has undertaken by virtue of its membership in the GATT.

It extends the GATT. An important achievement of the Agreement is that it goes well beyond the scope and coverage of current GATT obligations. It includes important trade-liberalizing measures in agriculture, services, business travel, and investment, and a commitment to develop bilateral rules for trade remedies.

It includes the principle of national treatment. Under this principle, each country maintains its policy independence while being prevented from using its policies to discriminate between domestic and foreign goods and, where applicable, between domestic and foreign investors.

It protects existing discrimination laws. With the exception of trade barriers, the Agreement leaves in place most existing policies that discriminate between foreign and domestic firms and products. Existing programs, practices, and policies are exempt from all obligations of the Agreement, except where they are explicitly included.

It improves dispute settlement. Although it falls short of many people's expectations in this area, the Agreement incorporates dispute settlement mechanisms that are clearly superior to those in the GATT, and probably superior to those in all other regional trade-liberalizing pacts.

It is an evolving arrangement. The Agreement is not a static arrangement; it will evolve as experience develops. Continued negotiations to alter fair trade laws are mandatory, as are notification and consultation on proposed unilateral changes to national laws that affect these rules. Consultations on a wide range of other issues can also be initiated at the request of either party.

Access through the Agreement

The object of the Agreement is to improve the access of each country's exporters to the other country's market. Whatever its shortcomings, the Agreement provides for much more liberalization

of trade, and for the removal of many more trade irritants, than does any other international trading agreement in existence today. It helps access in three ways: it increases the access of Canadian producers to the U.S. market, it makes that access more secure, and it promises to add to that security in the future.

The study demonstrates these propositions by working through the Agreement, chapter by chapter, and enumerating all the ways, large and small, in which it enhances the access of Canadian firms to the U.S. market. The results of this exercise can be summarized in three points.

First, the Agreement increases access in 18 identifiable ways, from the complete removal of tariffs on virtually all trade in goods to the easing of border crossings for business and service people, whose frequent harassment at the border today is a significant nontariff barrier.

Second, the Agreement makes access to the U.S. market more secure in eight ways. The Agreement achieves these gains in spite of the fact that Canada was unable to obtain a key objective: an agreed code to govern subsidy and antidumping practices. The list includes two really important gains: severe constraints are placed on the use of emergency actions to limit surges of imports, as was used recently against Canadian shakes and shingles; and the prohibition of quota restrictions ends their threatened use as a means of persuading Canadian firms to restrain their exports to the United States voluntarily.

Third, the Agreement mandates negotiations over the next five to seven years to revise laws governing antidumping and countervailing duties — the so-called fair trade laws. Opponents of the deal have ridiculed this achievement. Indeed, some prominent opponents have suggested that the Agreement be torn up because it does not exempt Canada from U.S. fair trade laws. Obtaining total exemption of one country from the other's domestic laws relating to trade was, however, always an unrealistic expectation. What one can hope for is piecemeal modification of the substance, and application, of these laws to allow them to fulfill their legitimate function of leveling the playing field while preventing them from acting as concealed trade barriers. This is no easy task. Negotiations to accomplish it are likely to be difficult and protracted. Only prolonged negotiations, with predetermined time limits, will shed light on how far Canada can, or should, go in negotiating revisions to fair trade laws. Although Canadians may be disappointed, they should not be surprised that

this task was not accomplished in the course of a mere 18 months of negotiations during which agreement was reached on a precedent-setting number of issues.

The GATT Itself Is Not an Alternative

Some critics argue that Canada could get just as much improved access through the Uruguay Round of GATT negotiations as is offered by the Agreement. The study refutes this view. It also argues that the Uruguay Round offers significant prospects for improved access to world markets that should be pursuued vigorously.

First, the Uruguay Round offers some chance of improving access by negotiating some cuts in some tariffs on some manufactured goods. Realistically, however, Canada can expect to get through the GATT only a small fraction of the full tariff reductions offered through the Agreement. The reason is that neither the United States nor Canada would be willing to extend to all other countries many of the tariff cuts that the Agreement contains. Would either country agree, for example, to remove all tariffs and nontariff barriers on textiles and clothing coming from Taiwan and Indonesia, or on cars from Japan and South Korea, or on red meat from Australia and Brazil, or on offshore energy imports (much though free traders might welcome these developments)?

Second, the Uruguay Round may also accomplish something on traded services. It would be optimistic, however, to expect more than a small part of the Agreement's liberalization with respect to this sector to be obtained from multilateral negotiations where concessions must be balanced among all the major bargaining parties.

Third, the GATT process may produce some concessions in agriculture. But it seems unreasonable to expect free trade in every agricultural product — except where U.S. and Canadian supply management schemes are in place — to be the outcome of this round of multilateral negotiations. Yet this is what the Agreement offers.

The GATT's dispute settlement mechanisms also may be improved. No serious commentators believe, however, that the U.S. Congress would agree to extend to all GATT signatories the binding dispute settlement procedure on trade law matters that the Agreement establishes. This procedure falls short of what many Canadians had hoped for, but it is surely much more than the United States would agree to in this round of GATT negotiations. (Nor is it clear that the Canadian government would be willing to extend these proposed measures to all countries.)

The Uruguay Round offers Canada virtually no significant prospects with respect to *any* of the large number of other gains in access offered by the Agreement and listed in the study, which will be lost if Canada rejects the Agreement and puts all of its eggs in the GATT basket.

Issues and Concerns

For each chapter of the Agreement, the study provides responses to a number of questions or concerns raised in the context of that particular chapter. A small sample of the chapter-by-chapter discussion follows.

Does the Agreement compel a general harmonization of social and/or economic policies?

Chapter 5 discusses this query. In some cases, such as the setting of standards, the Agreement urges *voluntary* harmonization (but does not mandate it). For virtually all broad social and economic policies, however, the Agreement calls only for national treatment, which leaves intact the sovereign right of each country to go its own way on all of its policies, as long as it does not use these policies as disguised barriers to international trade or investment. How unlike the horror stories so often heard that every Canadian policy in sight will have to be harmonized with its U.S. counterpart.

Does the proportional-sharing arrangement give the United States preferred access to Canada's resource supplies?

This question arises from the provisions of Chapter 9, which deals with energy, and which has led critics to accuse the Mulroney government of "selling out the shop". A careful analysis of this chapter leads to a rather different conclusion. Under normal circumstances, Canadian resources will be sold on the open market to all comers without preference. Any sharing comes into force only if Canada wishes to proclaim an emergency and then restricts both domestic output and exports to the United States.

Does the Agreement require that the price of Canadian exports to the United States be the same as the price charged in Canada?

Many of those who oppose the Agreement, including some in the highest political quarters, have spread the myth that the Agreement

controls the prices at which suppliers can sell their goods. The study dispels this myth outright. Canadian producers, including Crown corporations, *have not* relinquished their ability to charge prices that vary with market conditions and the conditions of supply on both sides of the border. Many commodities, such as oil and electricity, are sold under many different conditions at many different prices, and the Agreement does nothing to regulate the terms of commercial price setting. U.S. prices can be higher, or lower, than prices charged at home — subject, of course, to existing antidumping and other relevant laws. What the Agreement prevents is direct government intervention to impose specifically transborder price discrepancies.

Could the provision of universal, nonprofit social services such as child care be blocked because private U.S. firms now operating in Canada could use the Agreement to obtain compensation for lost revenues, thus making them eligible for provincial funding even if a province decided to fund only nonprofit groups?

This question relates to the controversial provisions of Chapter 14, which deals with services. The analysis of this chapter turns on the key point that services covered by the Agreement are bound by national treatment obligations, while noncovered services are not. Since child care is exempted from the provisions of the Agreement, by virtue of being a noncovered service, provincial governments can discriminate, if they so wish, against U.S. child-care firms, both in their operation and in their regulation. They can also prohibit such firms altogether. Furthermore, Canadian governments are free to subsidize domestic firms, and to deny these subsidies to U.S. firms.

Is the investment chapter a one-sided set of Canadian concessions in return for no real gain?

The main purpose of this chapter is to create, in the italicized words of the Agreement, *"a hospitable and secure climate of foreign investment in both countries that is necessary to achieve the full benefit of liberalized trade in goods and services."* The study points out that Canada is an important investor country — its stock of investment in the United States is increasing about three times as fast as is the stock of U.S. investment in Canada. It is, therefore, in Canada's own interest to get rules of national treatment installed before there is any backlash against the rapidly growing stock of foreign investment in the United States. A decade from now, this

achievement may turn out to have been one of the most far-sighted measures in the whole Agreement.

Can Article 2011, on nullification and impairment, be used to gain concessions that the Agreement does not otherwise allow?

Opponents of the Agreement commonly allege that this is so. Many of their arguments turn on the belief that this clause can be invoked under almost all circumstances. For example, some people have argued seriously that this clause is the loophole through which U.S. child-care chains will slip into Canada, where they are not wanted. The study shows this worry to be unfounded. Article 2011 clearly states that it covers only *benefits that could reasonably be expected to follow from the Agreement.* Since child care is one of the many activities excluded from the Agreement, there is no reasonable expectation of benefits that originate in Canada and go to U.S. child-care firms. Such firms thus have no reasonable recourse to this clause.

Should the Agreement Be Rejected?

Compared with what has been accomplished in the GATT and in other trade-liberalizing arrangements such as the European Community and the European Free Trade Association, the Agreement goes a long way toward providing Canadian exporters with security of access to the U.S. market. To argue that the Agreement should be rejected because it does not provide even more security of access, no matter how desirable that might be, is to make the very best be the enemy of the very good. Together, however, the Agreement and the Uruguay Round of GATT negotiations promise to provide a really significant increase in access to foreign markets for Canadian exporters.

The status quo — with its existing barriers to firms wishing to serve the combined markets of the two countries from a Canadian location, and continuing U.S. pressures toward further protectionism — fares poorly when compared with the Agreement's achievements on market access. The Agreement goes further and deeper on access than any other trade-liberalizing arrangement in the world today. The Agreement also seems to be better than any other bilateral treaty the two countries could negotiate in the near future if this one were to be rejected — assuming that the United States would be interested in negotiating again at all.

It is easy to see why some may wish to reject the Agreement because of those aspects that go beyond trade in goods — aspects that are discussed in detail in the study. For the Agreement to be rejected on the grounds that complete security of access was not obtained would seem to require a feasible plan to obtain greater security of access than the Agreement offers. No such plan seems to have been proposed.

The case for rejecting the Agreement, therefore, must lie in the argument that Canada has given up too much outside the sphere of trade liberalization to justify the real gains it stands to obtain by liberalizing trade. To assess this case, one needs to look at what the two countries have and have not given up in the Agreement. Much of the problem in doing so lies in identifying myths about sacrifices that some people allege the Agreement entails but that are not in fact required.

What Canada Has Given Up

On nontariff issues, here is what Canada appears to be giving up if it accepts the Agreement.

- Canada will no longer demand performance requirements of U.S. firms investing in this country. Insofar as they relate to exports and imports, these requirements are not consistent with Canada's GATT obligations in any case. Insofar as they relate to other matters, Canada's giving them up is a clear constraint on future policy, the importance of which depends on how one views the international investment scene. Those people who mistrust foreign capital wish to retain the right to impose such requirements. Others hold that the nationality of firms' owners is irrelevant to their behavior and that, although rules and regulations may be needed to control behavior, these rules need not distinguish between domestic and foreign firms. In any case, so these people argue, in the present globalized economy, it is unrealistic to expect foreign firms to accept restrictions on their behavior of the sort that they accepted in the 1950s and 1960s.

- Canada gives up the right to review all indirect takeovers, and direct takeovers worth between $5 million and $150 million. In return, it obtains an exemption from any review of foreign investment that the United States may introduce after the Agreement is in place. The world economy has become intensely internationalized, and investment flows are a key part of this

development. At most, the discouraging effect of reviewing direct takeovers of this magnitude would be marginal on these flows. Even if future reviews are as fierce as they were at the height of the activities of the Foreign Investment Review Agency in the 1970s, they will have only a marginal effect on the ownership of this country. To say, therefore, that this aspect of the Agreement constitutes a sellout of Canada to the United States seems a bit excessive.

• Canada gives up the right to levy export taxes on energy or to discriminate on purely nationalistic grounds between prices charged Canadian and U.S. buyers of Canadian energy. (Canadian firms can still charge different prices under different market circumstances.) Enough tools remain in the policy kit, however, to adopt any resource policies except those whose explicit object is to distinguish among energy producers or energy consumers on the basis of their nationality. Canada can, for example, tax resource rents, control the rate of extraction of nonrenewable resources, and adopt measures to encourage the exploration of new resources.

What the United States Has Given Up

The United States has agreed to several restrictions on its sovereignty.

The binational review of each country's final determinations on antidumping and countervailing duty cases is an historic concession on the part of the United States, which has long been reluctant to have its national decisions subject to international review. Although review takes place in the GATT, it lacks effective means of enforcement. The Agreement allows the binational review panel to pass judgment on the application of U.S. laws. Many trade lawyers feel this will have a salutary effect on the way in which the United States administers these laws, and on the decisions it takes.

Under the provisions of Chapters 4 and 11, the United States will no longer be able to use the threat of quantitative restrictions to pressure other countries into agreeing to voluntary export restraints. Since the United States has made frequent use of this policy tool in recent years, albeit rarely against Canada, this will probably be a significant restraint on U.S. actions.

Chapter 9 prevents the United States from cutting off Canada's access to U.S. energy markets on national security grounds, short of a genuine shooting war. Again, the United States has done this

to other countries in the past, on rather flimsy grounds, and so this, too, is a major constraint on its sovereignty.

The articles in Chapter 11, which limit the United States' right to take bilateral and global emergency actions against Canada, are another major constraint on U.S. policies that have operated frequently in the past — for example, against Canadian shakes and shingles. The circumstances under which the United States can take emergency action against Canadian imports are greatly constrained, and the amount by which these imports can be affected by such measures is much diminished over what it was in the past.

Finally, by agreeing to national treatment in investment, the United States effectively has tied its hands with regard to hostile policies directed at Canadian foreign investment — policies that may become attractive in the 1990s when Americans are likely to become increasingly concerned over their growing foreign ownership problem, in the same way that Canadians did in the 1970s.

The Balance

The net balance between what Canada has given up and what the United States has given up will be debated for a long time. The result may be a modest balance in either direction — *perfect* balances are rarely, if ever, struck in any bargaining process. Such calculations must be put in perspective, however, by understanding that most of the Agreement is win/win for both countries. If both win, say 100 points on mutually beneficial gains, it is irrelevant to argue over which country got, say, 5 net points on nontrade concessions and then to accept or reject the Agreement on that basis. Opponents, of course, feel that the net balance on nontrade items is large. Our tour through the Agreement does not tend to support this charge. To reject the Agreement is to give up major gains in market access and to risk turning Canadian policies in the wrong direction — away from accepting globalization and toward the now-obsolete inward-looking policies of the 1970s.

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Richard G. Lipsey and Robert C. York

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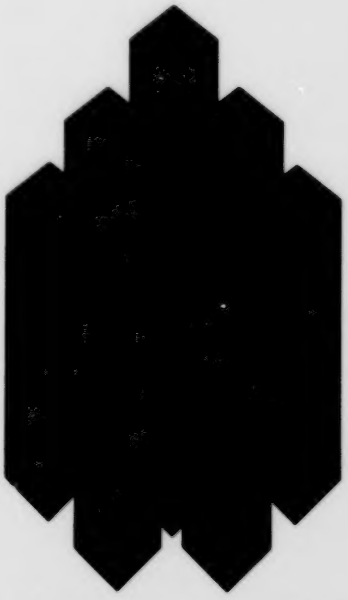

A Guided Tour through the Canada-U.S. Agreement

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The Institute was created in 1973 by a merger of the Private Planning Association of Canada (PPAC) and the C.D. Howe Memorial Foundation. The PPAC, formed in 1958 by business and labor leaders, undertook research and educational activities on economic policy issues. The Foundation was created in 1961 to memorialize the late Rt. Hon. Clarence Decatur Howe, who served Canada as Minister of Trade and Commerce, among other elected capacities, between 1935 and 1957. The Foundation became a separate entity in 1981, and it continues to provide funding to the Institute.

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Foreword

Since 1985, the C.D. Howe Institute has been proud to play a role in the policy discussion concerning the liberalization of bilateral trade between Canada and the United States, one of the most significant policy debates in Canada in this century. The Institute has published numerous studies examining arguments for and against a free trade agreement, from both an overall and a sectoral perspective. Over that period, Canada has moved significantly closer to a bilateral trade deal with the United States.

Dr. Richard G. Lipsey, the Institute's Senior Economic Advisor, has led the analysis and co-authored the two most important studies that the Institute has published on this strategic trade option.

The first of these studies, *Taking the Initiative: Canada's Trade Options in a Turbulent World*, by Dr. Lipsey and Murray G. Smith, laid out Canada's need to increase and secure its access to the U.S. market as part of the strategic response to the new global competitive trading environment.

The second of these major contributions is the present study, *Evaluating the Free Trade Deal: A Guided Tour through the Canada-U.S. Agreement*, by Dr. Lipsey and Robert C. York.

This book is the culmination of the authors' many months of rigorous study of the final text of the Agreement, and of their discussions with numerous experts, including those in the Trade Negotiations Office, government officials, participants in the Sector Advisory Groups on International Trade, and other industry experts.

There are three reasons why the Institute believed it was important to publish this study.

First, because of its technical language, the Agreement needed to be interpreted and translated into layman's terms in order to spread a clearer working knowledge of the Agreement among the public.

Second, as myths about the Agreement's contents grew, the need for a clear, rational presentation of its provisions became imperative.

Third, in fulfilling the first two objectives, the study would provide the reader with an objective summary and analysis of the Agreement that could be used as a stand-alone document or as an accompanying document to the Agreement itself.

The authors thus summarize the Agreement, chapter by chapter, and then go on to discuss what the Agreement actually contains, misinformed debate notwithstanding. At the same time, they address the many concerns that critics of the Agreement have raised and attempt to dispel the myths that have grown up about the Agreement's implications.

The authors' key conclusion is that, on balance, the Agreement achieves significant progress toward improving access to the U.S. market and toward making that access more secure. The authors point out, however, that Canada's best trade strategy is to pursue multilateral negotiations in the GATT in conjunction with the Canada-U.S. Agreement.

More importantly, this Agreement should be regarded as being only a part, albeit a key one, of Canada's response to increasing global competition. Ensuring Canada's prosperity in the 1990s and beyond will require enlightened policies toward science, education, technology, innovation, and industrial change along with entrepreneurial trade initiatives. The Agreement will only be successful if it turns Canada toward an outward-looking policy — one that responds to globalization — and away from, as the authors put it, "the now-obsolete inward-looking policies of the 1970s."

As with all Institute studies, the conclusions presented here are those of the authors; they do not necessarily represent the views of the Institute's members or directors.

Maureen Farrow
President
June 1988

Preface

My involvement with a possible free trade arrangement between Canada and the United States began when I was asked in the summer of 1983 to write a chapter on Canadian-U.S. economic relations in a book on general relations between the two countries sponsored by the American Assembly.[1] As I delved into the post-Confederation history of Canadian economic policy, I found myself driven, to my surprise, to the view that in today's competitive trading world, the market access that Canada needed as a major trading country might best be ensured by a bilateral trade-liberalizing agreement with the United States — pursued in parallel with the fainter hope of gaining significant market access through the Uruguay Round of GATT negotiations.

I then joined forces with Murray Smith to study Canada's trade options in more depth. We presented the results of our studies in *Taking the Initiative: Canada's Trade Options in a Turbulent World*.[2] We concluded that bilateral trade liberalization was the best hope for increasing the access of Canadian exporters to the U.S. market, and we argued that this could be achieved without a significant erosion of Canadian sovereignty. Our book came out a few months before the report of the Macdonald Royal Commission, and was the subject of several meetings between economists from the C.D. Howe Institute and senior government officials concerned with trade issues.

In September 1985, the Canadian government approached the U.S. government and, in October 1985, after some cliff-hanging intricacies, the United States agreed to negotiate a bilateral trade-liberalizing agreement with Canada. The

[1] *Canada and the United States: Enduring Friendship, Persistent Stress* (Englewood Cliffs, N.J.: Prentice-Hall, 1985).

[2] Richard G. Lipsey and Murray G. Smith, *Taking the Initiative: Canada's Trade Options in a Turbulent World*, Observation no. 27 (Toronto: C.D. Howe Institute, 1985).

negotiations began late in the spring of 1986, and ended in the fall of 1987. A preliminary Agreement was signed in October 1987, just in time to meet the U.S. negotiating schedule. Then, in December 1987, the final text of the Agreement was published. It is to be hoped that 1988 will see the passage of mutually acceptable enabling legislation by the U.S. Congress and the Canadian Parliament.

During this period, the Canadian debate on the Agreement has risen to dramatic heights. The C.D. Howe Institute has done its best to keep careful tabs on the debate through monitoring newspaper articles, op-ed pieces, and media events. I have personally given over a dozen presentations to parliamentary committees at the federal and provincial levels and to other official bodies. In addition, I have made a series of crosscountry speaking tours, mainly directed at Canadian Club audiences, attended literally dozens of academic conferences on the free trade issue, and written many commentaries for publication in the proceedings of such conferences. In May 1987, I gave the convocation address at Carleton University in Ottawa.[3] The topic I chose was the "Great Free Trade Debate and the Canadian Identity". In this speech, I argued that the roots of the Canadian identity run too deep to be destroyed by continuing a policy that Canada has followed for the past 50 years: increasing access to U.S. markets for successful Canadian exporters.

In November 1987, I wrote a brief survey of the Great Free Trade Debate, which was published as the first issue in the C.D. Howe Institute's new *Trade Monitor* series.[4] Near the end of January 1988, after attending several conferences that seemed to do little to add to the public's awareness of the real issues involved in the debate — I decided that the best way to do justice to the Agreement was to let its substance speak

[3] "The Great Free Trade Debate and the Canadian Identity" (Text of Convocation Address to Carleton University, Ottawa, May 1987).

[4] Richard G. Lipsey, *The Canada-U.S. Free Trade Agreement and the Great Free Trade Debate*, Trade Monitor no. 1 (Toronto: C.D. Howe Institute, 1987).

for itself. I then joined forces with Robert York, and we worked through February and March 1988 to understand the Agreement, to appreciate its implications, and to evaluate the debate that had grown up around its contents. This required that we attend numerous conferences with trade negotiators, trade lawyers, and economists with GATT experience. In April 1988, we completed the manuscript of this book.

Throughout the 1985–88 period, my researches strengthened the view that I found myself flirting with in 1984 — namely, that Canada's best hope as a trading nation lies in a bilateral trade-liberalizing arrangement with the United States, pursued in conjunction with an effort to get as much as possible from the Uruguay Round of GATT negotiations. Looked at from overseas — from the aspect of those groups of countries that have struggled over the past three decades to get as much as possible out of their numerous regional trade-liberalizing pacts — the Agreement is a stunning achievement. Canadians worry that it did not achieve enough. To have achieved two-thirds of what the Canadian and U.S. negotiators accomplished in 18 short months would have been regarded as pathbreaking by the negotiators of virtually all other regional trade-liberalizing arrangements. As late as the summer of 1987, the European trade expert Victoria Curzon Price was warning Canada's negotiators that they might be trying for too much.[5] In her view, they certainly were trying for far more trade liberalization than any other regional agreement had achieved over decades, let alone in the first round of negotiations. Yet, by October of that year, we knew they had succeeded in doing what Curzon Price worried might be beyond their capacities.

Canada's negotiators possibly could have done even more. By the world's standards, however, to turn down the Agreement on the grounds that it does not do enough to increase market access or make that access more secure is to let the best be the enemy of the very good.

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[5]Victoria Curzon Price, *Free Trade Areas, the European Experience: What Lessons for Canadian-U.S. Trade Liberalization?*, Observation no. 31 (Toronto: C.D. Howe Institute, 1987).

The best case for rejecting the Agreement seems to be that Canada has given up too much with respect to nontrade-related limitations on future Canadian policies to provide a reasonable balance for the clear gains that were achieved on market access. Maybe so, and maybe not. In the course of this study, Robert York and I try to lay out all of the serious objections to the Agreement that we can find in the voluminous file of clippings we accumulated while tracking the Great Free Trade Debate.

This *Policy Study* is dedicated to those who wish to understand both the Agreement itself and the issues of policy that are really involved in deciding whether or not the Agreement should be accepted.

Many people have helped, and only a few can be singled out. My co-author, Robert York, has been tireless in coping with the many problems of understanding and interpretation that faced us at every stage of our work. Ted Carmichael, Katie Macmillan, Maureen Farrow, Alan Nymark, Charles Stedman, John Crispo, and Murray Smith read the manuscript in one or more of its many versions and contributed greatly to its present state. Elaine Fitzpatrick and Cordelia Sharpe coped with skill and fortitude with mountains of manuscript. Barry Norris' thorough and thoughtful editing greatly increased the readability of the final product.

Richard G. Lipsey
Toronto
April 1988

Introduction: An Overview of the Agreement

The final text of the Canada-U.S. Free Trade Agreement has been available since December 1987. Supporters and opponents of the Agreement recognize that it is an historic document. Accepting or rejecting it will have both real and symbolic effects that will persist for decades, possibly for centuries.

During the debate over the Agreement, a staggering number of errors of fact and interpretation have been published. It is difficult for the public to develop an informed opinion about the Agreement when ten different authors provide ten different versions of its contents on ten consecutive days. Few Canadians can be expected to read the Agreement, much less to penetrate the opaque language in which it is sometimes couched. Furthermore, the language of the Agreement is often copied from that of the General Agreement on Tariffs and Trade (GATT), and a knowledge of GATT rules and precedents is needed to appreciate the significance of many aspects of the Agreement's clauses.

The purpose of this study is to foster informed debate over the real content of the Agreement. We have tried to do this by letting the substance of the Agreement speak for itself as much as possible. In this Introduction, we put the Agreement in its historical perspective and then provide a brief overview of the Agreement's contents to show what it provides by way of access to the U.S. market. We then work through the Agreement a second time, chapter by chapter, discussing the significance of each chapter and showing what light the Agreement itself throws on the many controversies to which it has given rise.

We have done our best to guard against significant errors of fact by carefully checking our text against the text of the Agreement and that of the GATT, and by obtaining the opinions of trade lawyers and trade negotiators. Others may place

a different interpretation on the value of the various Articles of the Agreement than do we, but we hope to shed some light on the actual contents and significance of the Agreement.

This assessment is written from the Canadian point of view. Much of the Agreement concerns "win-win" situations; when we stress Canada's gains, this is not meant to imply parallel losses for the United States. Parts of the Agreement have impacts — some favorable and some unfavorable — on firms in third countries that wish to invest in, or sell to, Canada and the United States. Important though these effects may be, they are beyond the scope of this study.

The Agreement in Historical Context

The first Canadian-U.S. experiment with free trade began with the *Reciprocity Treaty* of 1854, which eliminated tariffs on most crossborder trade. The United States later abrogated this treaty, partly as a retaliation for Britain's obvious favoritism of the South during the U.S. Civil War. During the first decade after Confederation, Canadian governments sought vainly to restore the treaty. When these attempts failed, Canada turned inward. Sir John A. Macdonald's National Policy, introduced in 1879, was aimed at building a Canadian industrial base behind tariff walls. It succeeded in creating a largely branch plant manufacturing industry based on servicing the low-volume home market with high-cost production that was shielded by import duties.

In the 1930s, Canadian trade policy shifted decisively, toward an outward-looking stance. This occurred because of two sets of pressures. First, by this time, some Canadian manufacturing had passed the infant-industry stage and was ready to begin its full integration into the world trading economy. Second, the high tariffs established in the United States by the *Tariff Act of 1930* — commonly referred to as the *Smoot-Hawley Act*, after the originators of the legislation — and in Canada by the Bennett government clearly were harming both countries by restricting their mutually profitable trade.

As a result of these pressures, Canada signed two major trade-liberalizing agreements with the United States in the mid-1930s. Then, in 1947, Canada became a charter member of the GATT. This committed Canada to a policy of liberalizing its foreign trade, and confirmed its rejection of an inward-looking policy based on heavy protectionism.

The GATT

The GATT is arguably the most successful of all the international institutions that were established after the end of World War II. It has presided over major reductions in trade barriers that have caused dramatic increases in world trade. Its success is based on three main features.

- GATT members meet periodically to reduce tariffs. In each of these meetings, called "rounds", members bargain bilaterally to reduce tariffs on the understanding that all reductions will be extended to all GATT members on a "most-favored-nation" basis. So far, the two most successful rounds of GATT negotiations have been the Kennedy Round in the 1960s and the Tokyo Round in the 1970s.
- The GATT lays down a set of rules for fair play on international trade and investment.
- Although the GATT exists only as a treaty, with no formal organization *per se*, it has evolved a reasonably satisfactory procedure for handling violations of GATT commitments by its members. Trade disputes initially are dealt with by GATT panels, which decide whether or not particular national policies conflict with that country's GATT obligations. Dispute resolution then usually occurs on the basis of consensus and compromise. This process usually leads members to change their policies voluntarily when these are ruled to be inconsistent with GATT obligations. If this is not done, the only recourse for offended parties is to take retaliatory action that has an effect equivalent to that of the offending policy.

Since the early 1970s, concern has grown over the GATT's ability to sustain world trade liberalization. One reason for this concern is that the GATT does not cover trade in services, the growing volume of which is one of the dramatic developments in recent trade patterns. The most important reason, however, is that the GATT's success in rolling back tariffs has been partly offset by the growth of nontariff barriers to trade, usually referred to as NTBs. As the term suggests, a nontariff barrier is any instrument other than a tariff that is used to restrict trade. Examples are import quotas, voluntary export restraints (VERs), the application of different standards to domestic and imported goods, and various forms of harassment by customs officials when goods cross a country's border. One of the most serious sets of nontariff barriers in place today has arisen from the misuse of domestic laws designed to establish the rules of fair trade. (These laws are discussed in Box 1.)

A new round of GATT negotiations, the Uruguay Round, is just getting under way. Its main objectives are to deal with nontariff barriers to trade, with trade in services, and with the distorting effects on world trade in agricultural goods that are caused by heavy domestic subsidization of agriculture in many countries, including both Canada and the United States.

The outcome of the Uruguay Round cannot yet be foreseen. Some observers remain optimistic that it will achieve significant gains; others fear that the GATT will be unable to maintain even the current degree of liberalized trade, let alone liberalize it still further.

The Importance of Access

Canada is a small trading country with close to 30 percent of its income and employment generated directly by exports. Together with Australia and New Zealand, Canada is the only developed country whose industries do not have free access to a market of at least 100 million consumers. Consider the numbers:

- the Japanese domestic market is 120 million people;

- the U.S. market is 240 million people;
- the combined market of the European Community (EC)[1] and the European Free Trade Association (EFTA)[2] is 360 million people;
- the Canadian market is 25 million people;
- the combined Australian and New Zealand market is 20 million people.

Earlier in this century, Canada's exports were mainly primary products. Because Canada was a major, and in some cases almost the only, supplier of these products, the world beat a path to Canada's door. Market access for Canadian exports was not then a serious issue. Today, markets are much more competitive. The number of countries selling primary products has increased, technological revolutions have introduced many substitutes for these products, and Canada is now a major exporter of manufactured goods over which international competition is fierce. As a result of these developments, market access is now a key issue for Canadian exporters.

The bilateral agreements made in the 1930s with the United States and successive GATT rounds of tariff reductions have removed something like three-quarters of the Canadian trade barriers that were in place in 1935.[3] Although this is an impressive result, and although much Canadian-U.S. trade now moves completely tariff free, the remaining U.S. tariffs still exert a substantial restraining effect on Canadian exports to that country. Measures of average tariffs, or of the volume of

[1]The European Community, founded in 1957, provides free trade in goods and a common tariff against nonmember states for its 12-country grouping. The EC also has an explicit commitment to harmonize members' social and economic policies.

[2]The European Free Trade Association, founded in 1960, is a collection of six countries that enjoy free trade in goods among themselves while having independent trade policies with nonmember countries. They also have individual free trade agreements with the EC.

[3]This is not an easy number to measure precisely, but most observers place it between 70 and 90 percent.

Box 1

Trade Remedy Laws

All countries that engage in international trade have a set of domestic laws governing unfair trading practices — variously called "fair trade" or "trade remedy" laws. These allow trade restrictions — often called "contingency measures" — to be introduced whenever two conditions are fulfilled. First, when there is "unfair" competition from foreign exports, and, second, when these exports are found to be injuring domestic industry. Injury describes a situation whereby foreign imports cause a significant decline in domestic production, lost sales, loss in market shares, declining profits, and the like. In the popular terminology, fair trade laws are meant to "level the international trade playing field".

The three main trade remedies in widespread use today are: countervail, antidumping, and temporary import relief.

Countervail

Under countervail, a country can levy duties on an import to offset subsidies received by the foreign exporter from its own government. In principle, therefore, countervail is a protection against "unfair" competition arising from government subsidization of the production of goods that are subsequently exported. It protects domestic producers against "unfair", government-subsidized, foreign competition.

According to the current interpretation, only foreign subsidies that are "specific to an industry or group of industries" are countervailable, while subsidies generally available across the whole economy are not. For example, tax credits for research and development, which are available to all Canadian-based firms, and unemployment insurance, which is available to all Canadian workers, are not countervailable, but Canada's special regional investment tax credit is.

The theory of the level playing field is hard to object to in principle. In practice, however, countervail can become a potent barrier to trade because of varying judgments about whether or not particular foreign subsidies are countervailable. In the case of Canadian softwood lumber, for example, long-standing Canadian resource policies were twice investigated and found

Box 1 - continued

noncountervailable. On a third investigation, they were judged to justify a countervailing duty. It is hard to avoid the conclusion that the most significant change between the time of the first and the last of these decisions was the U.S. political and economic climate, rather than Canadian resource policies.

Antidumping

Antidumping duties generally are designed to prevent firms from selling goods in foreign markets at prices below those at which they are sold in their home market — although the test for dumping varies in complex ways at different times and places.

In practice, however, antidumping duties can be more than just a "fair trade measure". Depending on how dumping is defined, and depending on the time and money that a foreign firm must expend to resist an antidumping complaint, such duties can become significant obstacles to trade.

Temporary Import Relief (or Emergency Action Safeguards)

From a Canadian perspective, one of the most worrisome developments in U.S. trade policy has been the growing tendency to resort to "temporary" import restraints for industries subject to intense international competition. These import relief measures are distinct from other actions under U.S. trade legislation, such as antidumping or countervail, which are intended to ensure fair trade. There is no such rationale for import relief actions.

There are two main ways to implement import restraints. One is through the formal imposition of quotas or tariff surtaxes. The other is through voluntary export restraint (VER) agreements, whereby the exporting country agrees to restrict its exports, often to avoid the importing country's threat of even more severe restrictions. Arrangements of this type pervade the clothing and textile sector and, more recently, specialty steel.

A safeguard provision is intended to provide a safety valve for pressures arising from sudden changes in international competitiveness. However, the frequent use of safeguard action tends to undermine the basic principle of liberalized trade: that market competition should determine trade patterns.

trade that now moves duty free, do not give an accurate picture of the effects of the complex structure of existing tariffs. The peaks and valleys of the tariff structure continue to distort bilateral trade flows in various ways.

First, tariffs are particularly high on petrochemicals, textiles, fashion goods, clothing, and some types of electronic and telecommunications equipment. Second, existing U.S. tariffs inhibit Canadian exports most strongly in the "up-market" type of manufactured commodities into which Canada needs to be moving if its industries are to avoid competing with low-income countries in the production of low-value-added commodities. Third, because tariff rates increase with the degree of processing, the *effective* rates of duty are much higher than the *nominal* rates. The differential between effective and nominal rates is particularly high on manufactured goods. These high effective rates reduce the incentives to manufacture in Canada goods that use Canadian raw materials but that are destined for the U.S. market.[4]

Current Policies for Access

Current Canadian policy is to pursue access to foreign mar-

[4]The distinction between a *nominal* and an *effective* rate of tariff is most easily shown in an example. A particular product is manufactured in both Canada and the United States from a Canadian raw material. The raw material enters the United States duty free, but the manufactured good is subject to a nominal 10 percent tariff. When the product is manufactured in Canada, the raw material accounts for one-half the cost of the final product and the other half is the value added by the Canadian manufacturer. Given these conditions, a unit of the product that represents a dollar's worth of Canadian output will sell in the United States for $1.10 because of the tariffs.

Next, consider the position of a U.S. manufacturer. Assume that the U.S. firm is not as efficient as the Canadian firm, so that its production costs are 20 percent higher. This means that, to produce the same unit of output, the raw material costs the U.S. firm $0.50, but its other costs — including its markup — are $0.60. This gives the U.S. firm a final price of $1.10, which is just low enough to compete against the tariff-burdened Canadian import. Thus, in this example, a nominal tariff of 10 percent on the value of the final product is sufficient to protect a U.S. manufacturer that is 20 percent less efficient than its Canadian competitor. This 20 percent represents what economists refer to as the effective rate of tariff.

kets on two main fronts: the Canada-U.S. Free Trade Agreement and the Uruguay Round of GATT negotiations.

When the Canadian government approached the U.S. government in the autumn of 1985 to request that negotiations begin on a bilateral free trade agreement, it had a number of objectives in view.[5] When Prime Minister Mulroney informed the House of Commons on September 26, 1985, that he had approached the U.S. government "to express Canada's interest in pursuing a new trade agreement between our two countries," he stated that Canada's objectives were "to secure and improve our trade with the USA" by negotiating the "broadest possible package of mutually beneficial reductions in tariff and non-tariff barriers between our two countries."[6]

The then Minister for International Trade, James Kelleher, gave more detail on Canada's negotiating objectives. He stated these as follows:

- *security of access* to the United States market, particularly by reducing the risks inherent in the U.S. system of restrictive trade measures (e.g. quotas, surtaxes, etc.) and the constitutional powers of the Congress to pass protectionist legislation affecting Canada;
- *expanded access* to the United States market in order to provide Canadian industry with a market large enough to realize economies of scale and specialization, and to carve out niches for specialty products;
- *a stable North American trading system* which would encourage an *orderly transition* in Canada towards an economy more competitive at home and in world markets, and provide increased incentive for investment from all sources;

[5]These objectives were discussed in detail in Richard G. Lipsey and Murray G. Smith, *Taking the Initiative: Canada's Trade Options in a Turbulent World*, Observation no. 27 (Toronto: C.D. Howe Institute, 1985), a volume that was widely discussed in Ottawa at the time; and, subsequently, in the final report of the Macdonald Commission (Canada, Royal Commission on the Economic Union and Development Prospects for Canada, *Report*, 3v. [Ottawa: Supply and Services Canada, 1985]).

[6]Rt. Hon. Brian Mulroney, Statement in the House of Commons on Canada-USA Trade Negotiations, Ottawa, September 26, 1985.

- *an ordered and more predictable system* for managing the trade relationship and resolving disputes.[7]

Both Mr. Kelleher and the prime minister were careful to say that they fully supported the next round of GATT negotiations and that they saw no conflict between the GATT talks and the bilateral negotiations they were now proposing.

An Overview of the Agreement

It is worth noting at the outset that, other than Japan, Canada is the *only* member of the Organisation for Economic Co-operation and Development (OECD) that is not in some form of regional trade-liberalizing arrangement. Furthermore, many less-developed countries are also in regional groupings. These facts reflect the simple assessment that many governments, of many political complexions, have made: that in today's highly integrated world, large markets really matter.

The Canada-U.S. Free Trade Agreement dismantles most of the existing restrictions on Canada's trade with the United States, its largest trading partner. This means that it comes close to completing the program, begun in 1935, of integrating the Canadian economy into the world trading system.

What is new in the present Agreement, compared with any liberalization of trade negotiated through the GATT, is that it covers only trade with the United States, not trade with all countries. This may well have political and symbolic consequences, which we discuss later. However, since close to 80 percent of Canada's foreign trade is with the United States, it is hard to believe that the economic consequences of Canadian-U.S. trade liberalization will differ significantly from those of previous multilateral, GATT-negotiated, trade liberalizations — all of which were adopted without national

[7]Hon. James Kelleher, Text of Report by the Minister for International Trade to the Rt. Hon. Brian Mulroney, Prime Minister of Canada, Ottawa, September 26, 1985. The text of the quote is taken from the press release that accompanied Kelleher's report.

debate, and carried through without nationally noticed dislocation.

The Agreement was negotiated over an 18-month period starting in May 1986 and ending in October 1987. A preliminary outline was published in October and the final text in December of 1987. In 1988, the Canadian and U.S. governments intend to pass enabling legislation embodying the terms of the Agreement. The first tariff cuts are then scheduled for January 1, 1989.

Main Characteristics of the Agreement

It promotes free trade. The main theme of the Agreement is to establish, and to preserve, free trade between Canada and the United States in virtually all manufactured goods, many agricultural goods, and a range of traded services.

It is GATT-like. The Agreement is founded mainly on the GATT and on GATT principles. Many clauses — including some of those that have come under severe criticism — merely repeat obligations Canada already has undertaken by virtue of its membership in the GATT. By embedding GATT rules and regulations in the Agreement, both countries have restated the agreed rules of international trade. The Agreement makes these rules more visible, and possibly more enforceable, than they are under the GATT.

It extends the GATT. An important achievement of the Agreement is that it goes well beyond the scope and coverage of current GATT obligations. It includes important trade-liberalizing measures in agriculture, services, business travel, and investment, and a commitment to develop bilateral rules for trade remedies. These achievements recognize the changing structure of world trade, and provide a prototype for future multilateral and bilateral agreements.

It includes the principle of national treatment. The fundamental unifying principle of the Agreement is *national treatment.* Under this principle, each country maintains its policy independence while being prevented from using its policies to discriminate between domestic and foreign goods and, where applicable, between domestic and foreign investors. According to the principle of national treatment, all new government policies, rules, or regulations that do not directly inhibit trade are permissible as long as they meet a single key test: that they do not arbitrarily or unjustifiably discriminate between nationals of the contracting countries.

It protects existing discrimination laws. With the exception of trade barriers, the Agreement leaves in place most existing policies that discriminate between foreign and domestic firms and products. Existing programs, practices, and policies are exempt from all obligations of the Agreement, except where they are explicitly included. By such blanket "grandfathering" of laws as varied as those that control ownership of Canadian energy firms or that prohibit the export of raw logs, the Agreement guarantees that its impact — outside of trade barriers — will be on new laws, rather than on existing ones.

It improves dispute settlement. Although it falls short of many people's expectations in this area, the Agreement incorporates dispute settlement mechanisms that are clearly superior to those in the GATT, and probably superior to those in all other regional trade-liberalizing pacts. Disputes on the general operation of the Agreement are to be overseen by a cabinet-level committee and referred, if necessary, to a binational dispute-settling panel. Provisions for prior notification and consultation are meant to head off disputes arising from new legislation, rules, or regulations that conflict with the spirit and intent of the treaty. The binational appeal process is superior to the current route of appeal through national courts for two reasons. First, a fixed timetable shortens the appeal

procedure. Second, the possibility of binational scrutiny should increase the objectivity of the domestic decisionmaking process.

It is an evolving arrangement. The Agreement is not a static arrangement; it will evolve as experience develops. Continued negotiations to alter fair trade laws are mandatory, as are notification and consultation on proposed unilateral changes to national laws that affect these rules. Consultations on a wide range of other issues can also be initiated at the request of either party.

Access through the Agreement

The object of the Agreement is to improve the access of each country's exporters to the other country's market. Whatever its shortcomings, the Agreement provides for much more liberalization of trade, and for the removal of many more trade irritants, than does any other international trading agreement in existence today. It helps access in three ways: it increases the access of Canadian producers to the U.S. market, it makes that access more secure, and it promises to add to that security in the future.

These propositions are most easily demonstrated by letting the Agreement speak for itself. This is best done by working through the Agreement, chapter by chapter, and enumerating all the ways, large and small, in which it enhances the access of Canadian firms to the U.S. market. This exercise is reported in Boxes 2 and 3. The results may be summarized in three points.

First, the Agreement increases access in 18 identifiable ways, listed in Box 2, from the complete removal of tariffs on virtually all trade in goods to the easing of border crossings for business and service people, whose frequent harassment at the border today is a significant nontariff barrier.

Second, the Agreement makes access to the U.S. market more secure in a number of ways — eight are listed in Box 3.

Box 2

How the Agreement Increases Access

One can show how the Agreement allows Canadian exporters increased access to the U.S. market by working through it chapter by chapter, listing in the order in which they occur every measure, large and small, that has this effect. (All access-increasing measures are listed, whether or not a free trader would approve of them.)

1. Clear rules of origin remove all of the uncertainty currently associated with customs officers' *ad hoc* decisions as to what tariff is payable on specific items as they cross the border (Article 301).
2. All tariffs will be eliminated on all trade with the United States by 1998 (Article 401), although, in the case of fruits and vegetables, tariffs may be reinstated for a brief period at any time over a further ten years (Article 702).
3. By 1994, the United States will eliminate the use of customs user fees that are applied to all goods entering that country; currently, these amount to 0.17 percent of the value of the import transaction (Article 403).
4. The right of national treatment gives blanket assurance that the United States will not discriminate against Canadian producers in any activities covered by the Agreement, except where the treaty explicitly provides otherwise (Article 501).
5. Internal taxes, such as sales or excise taxes, no longer can be used as concealed trade barriers — for example, by levying rates on imports higher than those levied on domestic goods (Article 501).
6. The Agreement eliminates various nontariff barriers to trade, such as the common misuse of standards requirements (Article 603), and it addresses these barriers in a more comprehensive and obligatory way than does any other free trade area or agreement — including the provisions of EFTA, the EC, and the GATT.
7. The United States will recognize Canadian accreditation systems and product test data in an effort to reduce obstacles to trade (Articles 605–607).

Box 2 - continued

8. The Agreement will remove tariffs and quotas on all agricultural goods, except for quotas that are used to support supply management schemes — as in poultry and eggs (Articles 401 and 702).
9. The Agreement establishes free trade in red meats (Article 704).
10. The United States will allow unlimited access to its U.S. market for Canadian food products containing up to 10 percent sugar (Article 707).
11. The Agreement restrains the use of technical regulations as nontariff barriers to agricultural trade — for example, by relaxing U.S. meat inspection laws (Article 708).
12. The United States will recognize Canadian Whiskey as a distinct product and will not permit the sale of any product labeled as Canadian Whiskey unless it has been manufactured in Canada (Article 806).
13. Under the national treatment principle, the United States will allow British Columbia Hydro fair access to the distribution lines of the Bonneville Power Administration (Article 905.2).
14. The Agreement changes the rules of origin for automotive products to provide more protection against offshore parts producers and, thus, to increase the access of Canadian and U.S. parts producers to each other's markets (Article 1005).
15. The Agreement opens up some government procurement markets (Article 1304).
16. The Agreement protects free trade for a wide range of services industries by its inclusion of the right of establishment and the principle of national treatment (Articles 1401 and 1402).
17. Temporary entry for Canadian business people and service personnel (Article 1502) is to be easily granted, and an open and bilateral method for settling disputes over denied entry is to be established (Article 1504).
18. National treatment is extended to the establishment in the United States of Canadian business enterprises covered by the Agreement, thus increasing access for those businesses where a physical presence is needed if goods are to be sold (Article 1602).

Box 3

How the Agreement Increases Security of Access

The Agreement increases security of access to the U.S. market in a number of important ways. It also holds the promise of further increases in security of access in the future. Once again, one can allow the Agreement to speak for itself by working through it chapter by chapter and by listing these items as they appear.

Immediate Increases in Security of Access

1. The Agreement removes the threat of quantitative restrictions and the United States' ability to use them to force Canada to adopt VERs (Article 407, in combination with Articles 1101 and 1102).
2. The United States will give Canadian energy products increased security of access to its market. This is particularly important for oil and gas, uranium, and electricity (Articles 902 and 905).
3. The Agreement severely restricts the circumstances under which the United States can use national security to restrict imports of Canadian energy products (Article 907).
4. Because the Agreement strengthens the auto pact, free trade in automotive goods is made more secure and cannot be upset without abrogation of the entire Agreement (Article 1001).
5. Canada will no longer be hit by U.S. global safeguard actions aimed at others, thus removing the "sideswipe" problem that has arisen several times in the past (Article 1102).

The Agreement achieves these gains in spite of the fact that Canada was unable to obtain a key objective: an agreed code to govern subsidy and antidumping practices (see Box 1). The list includes two really important gains: severe constraints are placed on the use of emergency actions to limit surges of imports, as was used recently against Canadian shakes and

Box 3 - continued

6. The Agreement reduces the uncertainty caused by escape clause action — which was used, for example, against shakes and shingles — to a minimal level by severely constraining both the circumstances under which such action can be taken and its severity (Article 1102).
7. The dispute settlement procedure outlined in Chapter 19 will make the application of U.S. trade laws less politically motivated; in the opinion of many U.S. trade lawyers, this would have altered the softwood lumber decision had it been in place.
8. By shortening the appeal process to less than a year, the dispute settlement mechanism makes it easier to redress bad decisions (Article 1904). At present, appeals through the U.S. courts often take years; in the meantime, the duty must be paid.

Future Increases in Security of Access

1. The United States has promised to accord national treatment to Canadian financial institutions operating in U.S. financial markets by amending U.S. laws governing financial institutions — in particular, the *Glass-Steagall Act* (Article 1702).
2. The Agreement improves the prospects for increasing future access by requiring consultations designed to revise antidumping and countervail laws over the next five to seven years. This provides for the maintenance of *a degree of close consultations that would have been highly unlikely without the Agreement* (Article 1907).

shingles; and the prohibition of quota restrictions ends their threatened use as a means of persuading Canadian firms to restrain their exports to the United States voluntarily.

Third, the Agreement mandates negotiations over the next five to seven years to revise laws governing antidumping and countervailing duties — the so-called fair trade laws that are

discussed in Box 1. Opponents of the deal have ridiculed this achievement. Indeed, some prominent opponents have suggested that the Agreement be torn up because it does not exempt Canada from U.S. fair trade laws. Obtaining total exemption of one country from the other's domestic laws relating to trade is, however, an unrealistic expectation. As the C.D. Howe Institute pointed out before the Canadian government had decided to open negotiations,

> it is doubtful that the U.S. Congress would agree to exempt Canada from its countervail laws. Therefore, we do not consider this possibility further. If complete Canadian exemption from U.S. countervail is ruled out...[w]e give below some illustrations...of what might be agreed to.[8]

What one can hope for is piecemeal modification of the substance, and application, of these laws. The purpose is to allow them to fulfill their legitimate function of leveling the playing field while preventing them from acting as concealed trade barriers. This is no easy task. Negotiations to accomplish it are likely to be difficult and protracted. Although Canadians may be disappointed, they should not be surprised that it was not accomplished in the course of a mere 18 months of negotiations during which agreement was reached on a precedent-setting number of issues.

The Agreement provides for a degree of close consultations that would be *inconceivable* without it. Those who oppose the Agreement because it did not achieve a breakthrough on subsidies and antidumping have yet to explain how they expect to come even close to the level of consultations on these matters that is *mandated* by the Agreement.

Criticisms of the Agreement

Critics of the Agreement have raised three main concerns.

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[8]Lipsey and Smith, *Taking the Initiative*, p. 152. The whole of Chapter 8, "Negotiating Issues", is relevant here.

- Canada did not get sufficient change in its current access to the U.S. market to justify the concessions it made; in any case, Canada could obtain most of this increased access through the Uruguay Round of GATT negotiations.
- Canada made major, nontrade-related concessions that will severely restrict future Canadian policies that are in the national interest. The energy and investment provisions of the Agreement are major cases in point.
- The Agreement unleashes economic pressures that will force a wide range of Canadian policies to be harmonized with those of the United States. The extreme version of this concern leads to the popular slogan: "Rejecting the Agreement is the price of remaining Canadian."

These general concerns are best discussed in the context of the specific chapters of the Agreement to which they refer. Here, we discuss eight aspects of these concerns that relate to the Agreement as a whole.

Does the Agreement really provide a significant increase in access to the U.S. market for Canadian-based exporters?

Boxes 2 and 3 allow the Agreement to speak for itself on this matter. There is impressive evidence that Canada gained a major increase in access to the U.S. market.

Could Canada not get just as much improved access through the Uruguay Round of GATT negotiations as is offered by the Agreement?

Some prominent newspaper correspondents recently have asserted an affirmative answer to this question. The Uruguay Round offers significant prospects for improved access to world markets, and these should be pursued vigorously. However, these mainly cover only three of the points listed in Boxes 2 and 3.

First, the Uruguay Round offers some chance of improving access by negotiating some cuts in some tariffs on some manufactured goods. Realistically, however, Canada can expect to get through the GATT only a small fraction of the full tariff reductions offered through the Agreement. The reason is that neither the United States nor Canada would be willing to extend to all other countries many of the tariff cuts that the Agreement contains. Would either country agree, for example, to remove all tariffs and nontariff barriers on textiles and clothing coming from Taiwan and Indonesia, or on cars from Japan and South Korea, or on red meat from Australia and Brazil, or on offshore energy imports (much though free traders might welcome these developments)?

Second, the Uruguay Round may also accomplish something on traded services. It would be optimistic, however, to expect more than a small part of the Agreement's liberalization with respect to this sector to be obtained from multilateral negotiations where concessions must be balanced among all the major bargaining parties.

Third, the GATT process may produce some concessions in agriculture. But it seems unreasonable to expect free trade in every agricultural product — except where U.S. and Canadian supply management schemes are in place — to be the outcome of this round of multilateral negotiations. Yet this is what the Agreement offers.

The GATT's dispute settlement mechanisms also may be improved. No serious commentators believe, however, that the U.S. Congress would agree to extend to all GATT signatories the binding dispute settlement procedure on trade law matters that the Agreement establishes. This procedure falls short of what many Canadians had hoped for, but it is surely much more than the United States would agree to in this round of GATT negotiations. (Nor is it clear that the Canadian government would be willing to extend these proposed measures to all countries.)

The Uruguay Round offers Canada virtually no significant prospects with respect to *any* of the other points made in

Boxes 2 and 3. The bulk of these other gains in access will be lost if Canada rejects the Agreement and puts all of its eggs in the GATT basket.

Although the GATT does not offer anything like as much as does the Agreement with respect to Canadian-U.S. trade, it does offer significant gains in access to the markets of other countries. Thus, the Agreement *plus* the new GATT round promise to provide a major increase in trade liberalization.

Since the objective of the negotiations — to provide security of access to the U.S. market by gaining exemption from U.S. fair trade laws — was not achieved, shouldn't the Agreement be rejected?

The objective of the negotiations was access. Box 2 shows that greatly increased access was achieved. Box 3 shows that there are also some lesser gains in security of access. Significant progress thus was achieved in reaching the objective suggested in the question. As we have already observed, however, the Institute's position has been that the complete exemption of Canada from U.S. fair trade laws was neither an attainable goal nor even a desirable one. Some incremental changes in each country's fair trade laws and rules of application have always seemed to be the feasible route. But time is required to reach such compromises. Americans must learn the extent to which their country really provides subsidies; Canadians must realize how many of their subsidy policies could be dispensed with without compromising legitimate national goals. Too many Canadians seem to feel that a subsidies code is a license to carry on with the enormous battery of subsidies now in use. Instead, it would impose severe limits on future Canadian subsidy policy. The Institute is not yet persuaded that an agreed subsidies code would be in the national interest, and we would like to see one before deciding on its pros and cons. It seems clear to us, however, that many of those who now oppose the Agreement because it does not include an agreed subsidies code would oppose the Agreement even more

vigorously if it did have one — because they would reject the constraints on Canadian action that such a code inevitably would require.

The Agreement provides major increases in access, and mandates negotiations to develop an agreed code on subsidies and antidumping practices. To reject the Agreement because it did not achieve even more on access would seem to be letting the best be the enemy of the good. Only prolonged negotiations, with predetermined time limits, will shed light on how far Canada can, or should, go in negotiating revisions to fair trade laws.

It is easy to see why some may wish to reject the Agreement because of those aspects that go beyond trade in goods — aspects that are discussed later in this study. For the Agreement to be rejected on the grounds that complete security of access was not obtained would seem to require a feasible plan to obtain greater security of access than the Agreement offers. No such plan seems to have been proposed.

Does the Agreement make it more difficult for the federal government to use subsidies as a policy tool for objectives such as regional economic development?

Some provincial premiers have used this as a reason for opposing the Agreement. In fact, the Agreement has no legal consequences one way or the other on the ability of Canadian governments to subsidize. Such subsidies will be at risk to U.S. countervail actions just as much — no more, no less — as they were before the Agreement. It seems reasonable to judge the Agreement on the balance between its pluses and its minuses, and not on the places where it scores zero.

Some people have argued that Canada has given up all its bargaining chips in negotiating the Agreement, while failing to get a code that will exempt some regional subsidies from possible countervail action. To reject the Agreement on this count, however, requires a belief that better progress can be made by trying to negotiate *ad hoc* revisions to fair trade laws

than by working through the negotiating mechanisms mandated by the Agreement.

Doesn't the balance between what was obtained on access and what was given up in other areas make the deal a bad one for Canada?

This is the basis of the case for rejecting the Agreement because of those clauses that go beyond free trade in goods and services. To assess these serious concerns, one needs to understand what Canada has, and has not, given up through the Agreement. We will discuss these issues more fully as we work through the Agreement chapter by chapter, and we will return to this general concern in the conclusion.

One or two points need to be made now, however, about this concern. The main worry about nontrade aspects of the Agreement relates to an alleged loss of sovereignty — that Canadian governments will no longer be able to follow independent policies that are in the national interest. Opinions on what the Agreement implies for Canadian sovereignty vary widely. Some people hold that Canada has surrendered little that was significant; others believe that the Agreement threatens the very basis of Canada as an independent country.

When two or more sovereign countries sign a treaty, they agree to do some things and not to do others. Thus, it is not a valid criticism of any international treaty to say that it entails a loss of sovereignty — all treaties do so in one way or another. The real issue is: do the two countries' concessions constitute a mutually beneficial package?

There are two main ways in which an international treaty can affect sovereignty. First, the treaty itself can constrain sovereignty through what may be called *direct constraints*. Second, when a treaty is implemented, it may set up forces that constrain governments in their future exercise of sovereignty. These are "policy harmonization pressures", not directly called for in the treaty, but nonetheless caused by it. These may be termed *indirect constraints*.

This study assesses the Agreement itself. This requires a detailed consideration of the direct constraints on sovereignty. An analysis of the alleged indirect constraints is thus beyond the scope of this study,[9] but the Appendix briefly surveys the question of major indirect constraints that the Agreement might place on Canadian sovereignty.

Canada had asked for a comprehensive free trade agreement, and got an agreement that was not comprehensive and did not establish free trade. Shouldn't the Agreement thus be rejected as a failure?

Of course, when two negotiators, with different objectives, sit down at a bargaining table, neither can expect to achieve every objective in any draft agreement that emerges. Two questions then become relevant. First, does the draft agreement contain a reasonable number of the desired objectives? Second, would the bargainers' situations be better or worse if they reject the draft agreement and revert to the status quo? Complaints that an agreement does not obtain everything that was on everyone's wish list are not reasonable grounds for rejecting it.

To answer these two questions, let us examine whether or not the Agreement achieves Mr. Kelleher's four objectives:

- On the first objective, that of securing existing access, Canada did not get all that it might have wanted; however, the gains are significant, as shown in Box 3.
- On the second objective, that of expanded access, the gains are enormous, as outlined in Box 2, and are more than could reasonably have been expected when the negotiations began.
- On the third goal, that of providing a stable trading system, the Agreement surely succeeds. Canada's labor market and environmental conditions (clean cities without noticeable violence) are attractive. All that was needed to attract investment

[9]For a more detailed analysis of indirect constraints on Canadian sovereignty, see Richard G. Lipsey, *The Sovereignty Issue*, Trade Monitor no. 7 (Toronto: C.D. Howe Institute, 1988).

was the assurance of a stable climate for the North American trading system with access to the U.S. market from Canadian production bases. The Agreement provides this. Business will be much more secure in its access to the U.S. market. European and Asian investors are now developing a real interest in using Canada as a secure base from which to enter the U.S. market.
- The fourth goal, that of providing a better system of managing trade disputes, was only partly achieved; we discuss the real gains in this area later in the study. Much remains to be achieved in the future, but, importantly, the Agreement mandates negotiations to do just that.

Would Canada come close to achieving Kelleher's objectives by rejecting the Agreement and allowing the status quo to persist?

To answer this question, look again at Kelleher's four objectives, listed on pp. 9-10.

- It is hard to believe that Canadian exporters would have more security of access to the U.S. market if all eight gains outlined in Box 3 were rejected and the status quo accepted.
- It is hard to see how the dramatic increases in access to the U.S. market outlined in Box 2 could be achieved by any mechanism other than the Agreement over a time span of 10 to 20 years.
- If negotiations through the GATT succeed beyond average expectations, they might produce a stable North American trading system as a by-product. A more likely result, however, is that there would be small gains through the GATT, and major problems would remain in the North American trading system, problems which will be more serious without the numerous consultative and dispute-settling mechanisms established by the Agreement.
- Imperfect though the Agreement may be, no critic has shown how, if it is rejected, to establish a more ordered and predictable system for managing trade disputes.

Could a new, and better, agreement be negotiated if this one were rejected?

Of course, nothing can be certain in conjectures about the future. One reason for uncertainty about this question is that no one has laid out an agreement that is vastly superior to the existing one and that might have been mutually acceptable. But even if such a superior agreement were conceivable, achieving it would be difficult in the political atmosphere that would follow the rejection of the current Agreement. Would the United States agree to start all over again? If it did, how effective would the rising U.S. opposition to the Agreement then become? Right now, all of the special interests in the United States who stand to lose from trade liberalization are uniting to oppose the Agreement. But the advantage of the fast-track procedure is that the Agreement cannot be amended bit by bit as a result of special-interest pressures. But if the Agreement is opened for renegotiation, all these pressures would be applied throughout the negotiations. The end result would be an emasculated Agreement, or no Agreement at all.

Many wish to reject the Agreement because of its nonaccess aspects. These concerns are discussed in later chapters. It is difficult, however, to make a case for rejecting the Agreement because it does not achieve a reasonable proportion of Canada's initial bargaining objectives. It is hard to see how Canadian negotiators could have obtained more access than they did, given that they were operating in a real world where genuine give and take is necessary.

Outline of the Study

In the remainder of this study, we work through the Agreement, chapter by chapter, using three main headings: the *content* of the chapter, its *significance*, and questions and responses relating to *concerns* that are relevant to the chapter.

The Agreement is divided into eight Parts and 21 Chapters, and we discuss each chapter in the order that it appears. The Agreement contains a bewildering array of technical terms,

which we avoid where possible. Where we cannot, we define each term the first time it appears. For easy reference, these terms can be found in the Glossary that appears at the back of the book.

Readers who have followed the debate may be surprised to find how few monsters, ready to devour an independent and sovereign Canada, jump from the pages of this study (or from those of the Agreement). Canada is free to develop and to continue its own distinctive policies in all of the important areas that go to the heart of nationhood.

It takes little space to state worries, to appeal to emotions, or to make assertions about the contents of the Agreement. Analyzing genuine worries — to say nothing of rebutting emotional appeals and correcting errors — takes more space and usually provides less attractive copy. For these reasons, our treatment does not always provide light reading. Some will want to read the text from cover to cover, others may find it easier to sample its wares by focusing on the questions that are currently being debated. As the reader already will have discovered from this Introduction, these are easy to locate because they are printed in italics.

A number of people who were kind enough to offer comments on the manuscript have expressed the concern that in some of these questions, we are setting up straw men. We want to stress, however, that all of these questions have been repeated in public over and over again. Every one of them comes from major newspaper stories or editorials, from op-ed pieces by prominent commentators, from the publications of political parties, or from speeches by major politicians. Furthermore, each of these questions has been answered by prominent participants in the debate in ways that imply criticism of the Agreement. We have not used direct quotations only because it does not seem helpful to single out one particular source for each question and answer.

1

Objectives and Scope of the Agreement

Content

The Agreement sets out to establish a free trade area (Article 101).[1] It is designed to eliminate barriers to trade in goods and services, to facilitate conditions of fair competition, to liberalize conditions for investment, to establish procedures for administering the Agreement and for settling trade-related disputes, and to lay the foundation for further cooperation to enhance the benefits of the Agreement (Article 102). Article 103 obliges each of the two federal governments to take all necessary steps to ensure compliance with the intent and provisions of the Agreement within its own country. Article 105 states that each country is to extend national treatment with respect to investment and trade in goods and services, except where otherwise specified in the Agreement.

Significance

Article 101 refers to a free trade area, not to a customs union (which would entail a common set of trade barriers against the outside world) nor to a common market (which would entail completely free movement of labor and capital).

Something similar to Article 103 is found in most international agreements. Some commentators have worried, however, that by obliging the federal governments to ensure provincial

[1] A free trade area is the least comprehensive of the three main types of regional trade-liberalizing arrangements. It removes restrictions on trade between member countries, and it allows members to have their own independent policies on trade with nonmember countries. A customs union also harmonizes trade policies with respect to the rest of the world, while a common market does all this as well as allowing free movement of labor and capital among the member countries.

and state compliance, rather than just asking for their best efforts, the Agreement places severe constraints on provincial government policies. Yet, if national governments are to reach international agreements on matters relevant to the increasingly globalized economy, some procedure to enforce compliance with such agreements is surely needed.

National treatment, called for in Article 105, is the basic concept of the Agreement. National treatment allows either country to have any laws, rules and regulations, taxes, or other measures that it wishes. These may differ dramatically between the two countries, provided only that they do not discriminate on the basis of nationality. The Agreement contains important exceptions to the principle of national treatment; these are dealt with as they arise throughout the text.

Concerns

Does the Agreement mean that Canada must adopt U.S. trade restrictions, so that U.S. protectionism becomes Canadian protectionism?

The answer to this question, which was frequently asked earlier in the debate, is no. Because it sets up a free trade area, rather than a customs union, the Agreement does not regulate trade barriers against third countries. Canada is free to establish its own independent trade policy with respect to all other countries.

Does the Agreement mean that cheap U.S. labor can come to Canada to take jobs from Canadians?

Because it sets up a free trade area, not a common market, the Agreement leaves each country free to regulate immigration from the other. It allows only for the free movement of business and service personnel for *temporary work* that does not make them members of the other country's labor force.

2
General Definitions

Content

This chapter defines key terms that are used throughout the Agreement. Understanding these definitions is necessary to understanding the significance of the terms of the Agreement. No detailed comment, however, is needed on this chapter.

3

Rules of Origin for Goods

Content

According to Article 301 and its Annex, most Canadian goods can qualify for tariff-free access to the U.S. market in one of three ways: by being entirely produced in Canada; by having been imported from third countries, but further processed in a way that results in a change in the good's classification for tariff purposes (called the "material-transformation rule"); or, in some cases, by having at least 50 percent of the direct cost of manufacturing accounted for in Canada or the United States (called the "50-percent-of-direct-cost rule"). For certain goods, the requirement is for both a change in commodity tariff classification and the 50-percent-of-direct-cost rule. Any goods entering either country and not satisfying the rules of origin for preferential treatment will be subject to the lowest rate of tariff charged on that good when it is imported from other countries. (This is the "most-favored-nation", or MFN, tariff.)

In this chapter, the Agreement uses a new GATT nomenclature, the "Harmonized System", to classify commodities for tariff purposes and for the rules of origin. (The tariff schedules presented in Harmonized System language are published in a separate volume as Annex 401.2.) Many exporters will need expert assistance in determining which rules of origin apply to their particular products. Fortunately, this is a job that only needs to be done once. The rules will not be subject to arbitrary change or reinterpretation at the border. By removing some of the uncertainties currently associated with exporting and importing, the Agreement achieves a significant improvement in ease of access to the U.S. market. Article 303 ensures compliance by both countries, and allows for consultations and

revisions to the rules of origin to account for any changes in product categories or other related matters.

One important exemption to these rules of origin relates to apparel made in Canada, or the United States, from offshore fabrics. In view of Canada's traditional reliance on these fabrics, the Agreement makes an exemption to permit specified quantities of such apparel to be exported duty free to the United States. These quantities are determined by quotas that are set *well above* the current levels of trade. Canadian apparel exports containing offshore fabrics that exceed these quotas will be subject to the U.S. MFN tariff, since this trade does not qualify for preferential treatment.

These additional exports will, however, qualify for a duty drawback even if the fabric used does not originate in Canada or the United States (Article 404.8b). (A duty drawback is a repayment by the government to domestic producers for duties paid on imported goods, when these goods are subsequently re-exported or used in the manufacture of exported goods.)

Significance

As in any free trade area, each country will continue to operate its own external commercial policy. Rules of origin are necessary to prevent third-party imports from entering the country with the lower foreign tariffs and then being transshipped to the higher-tariff country without facing additional tariffs. These rules delineate which goods qualify for tariff-free treatment. The 50-percent-of-direct-cost rule is common in free trade areas. The choice is between applying it to direct manufacturing costs (the direct-cost rule), or to invoice values (the invoice-value rule), which includes overheads. The direct-cost rule provides higher protection against the use of components from third parties than does the invoice-value rule.[1]

[1]Consider an example in which the direct cost of manufacturing a Canadian product is $75 while overheads and profits are $25, making an invoice value of $100. For that product to be exported tariff free to the United States, the 50-percent-of-direct-cost rule allows $37.50 worth of imported components, while the 50-percent-of-invoice-value rule allows $50 worth.

As a comparison, EFTA uses the invoice-value rule, while the free trade area between Australia and New Zealand — the Australia-New Zealand Closer Economic Relationship — uses a variation of the 50-percent-of-direct-cost rule.

Concerns

Will Canadian industry be forced to compete tariff free with goods that are produced by third countries and enter Canada through the United States?

This concern has been expressed frequently regarding cheap Mexican goods made in plants located near the U.S. border (the so-called Maquiladora strip). Chapter 3 effectively rules out the possibility that goods that are wholly made in third countries will flood into Canada tariff free through the United States.

A more subtle version of this concern is that cheap components, adding less than 50 percent of direct cost, will be used in U.S. production. Because these products will meet the rules for U.S. origin, they will become the indirect means by which the high-wage Canadian economy will be flooded with the products of low-wage countries. Several comments are in order on this concern.

First, the international sourcing of component production is now a world-wide phenomenon. Canadian manufacturers do this and so do those in the United States. Thus, any competitive advantages conferred by foreign sourcing are present under the status quo. Removing modest tariffs on Canadian-U.S. trade will change competitive advantages by the amounts of these tariffs, not by the wage differential between Canadian and U.S. wages and those in some of the less-developed countries (LDCs).

Second, it is inconsistent to criticize the Agreement for concentrating on Canada's trade with the United States and at the same time raise the fear that it may provide a back door for Canada's trading more with the LDCs. Since the Agreement

will rationalize Canada's costs in trading with the United States, Canadians will have less to fear over trading with the LDCs, either by buying their goods directly or by buying them when they are incorporated as parts in goods made in the developed countries.

4

Border Measures

Content

Chapter 4 sets out the provisions of the Agreement relating to border measures. These are tariffs, tariff-related measures, quantitative restrictions, and other restrictive measures that impede the free flow of trade.

Tariffs

All tariffs are to be removed in a series of equal annual steps (Article 401). For about one-half of the dutiable trade, this process will be done in ten steps taken over nine years. Many industries on both sides of the border have agreed to reduce the phase-out period to five annual steps or to collapse it into one step, to be taken in January 1989.[1] The long list of industries that have agreed to this accelerated phase-out is testimony that many anticipate only modest adjustment problems.

Wherever both sides agree, the tariff cuts can be further accelerated. If other regional trade-liberalizing agreements are any guide, accelerations will be called for in many sectors.[2]

[1]There are only two minor exceptions to the general tariff reduction schedule: tariffs on certain specialty steel items will not be reduced until October 1, 1989, and tariffs on telephone switching equipment are to be phased out in three equal stages. There is also a list of 33 temporary tariff items (Article 401.7) for which Canada can increase the rate of tariff up to the Agreement's preferential rate during the transitional period when tariffs are being cut. A similar list exists for the United States.

[2]The Australia-New Zealand Closer Economic Relations Trade Agreement, signed in 1983, called for tariff cuts to be spread over five years. In the two-year review of the agreement's operation, liberalization arrangements were accelerated for many sectors (see Australia, Department of Trade, *Australia-New Zealand Closer Economic Relations: CER Future Progress* [Canberra: Government Publishing Service, 1985]). In the EC and EFTA agreements, tariffs were scheduled to be reduced over periods of ten and twelve years, respectively. During the transition period, however, tariff cuts

(continued)

Customs Matters

At present, the United States applies customs user fees to all goods entering the country. This fee, amounting to a fixed percentage of the value of the import (now set at 0.17 percent), is an impediment to trade and will be removed in stages by January 1, 1994 (Article 403). The Annex to Article 406 stipulates cooperation to ensure efficient, and effective, customs administration.

Duty Drawbacks and Waivers (Remissions)

The Agreement will eliminate duty drawbacks and duty remissions, both of which have been much used in the past to distort trade patterns. Duty drawbacks will be abolished on bilateral trade by 1994 (Article 404). The only exceptions are for citrus products and for fabric made into apparel not qualifying for duty-free treatment. Duty remissions (or waivers) will be removed by January 1, 1998 (Article 405). (Duty remissions are refunds of duty paid on imported parts and materials by Canadian firms, the refunds being conditional on the firms' meeting domestic production and/or employment requirements.) The automobile sector, where duty remissions will be continued, is the only exception to this rule.

Import and Export Restrictions

This section of the Agreement has caused a storm of criticism — particularly as it applies to energy products. To evaluate the debate, the contents of the section must be studied in some detail.

The Agreement confirms both countries' rights and obligations under the GATT with respect to import and export restrictions on two-way trade (Article 407). It also prohibits the

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[2]Continued . . .
were accelerated and eliminated over six and eight years, respectively. When the EC-EFTA free trade agreement was negotiated, a transitional period of less than five years, with five tariff cuts of 20 percent each, was put in place (see Victoria Curzon Price, *Free Trade Areas, the European Experience: What Lessons for Canadian-U.S. Trade Liberalization?*, Observation no. 31 [Toronto: C.D. Howe Institute, 1987]).

use of such unilateral import and export restrictions as quotas, minimum price requirements, and taxation measures that discriminate on the basis of nationality. It allows exceptions for the enforcement of countervailing and antidumping laws (Article 407) and for:

- relief in times of critical shortages of foodstuffs or other products essential to the exporting country;
- prohibitions necessary to conform with standards, or to classify or grade goods (pornography, for example); and
- domestic stabilization in agricultural and fishery products.

Article 407.3 also permits either country to limit, or prohibit, the importation of goods coming from third countries and entering through the territory of the other country.

Article 408 prohibits export taxes on goods shipped to the other country. Article 409 allows other export restrictions as long as they are consistent with GATT obligations — as specified in GATT Article XX (g), (i), and (j) — and used for the following reasons:

- to conserve exhaustible resources, when such measures are made in conjunction with restrictions on domestic production or consumption;
- to restrict exports of domestic materials so as to ensure adequate domestic supplies in periods when the domestic price of these materials is held below the world price as part of government stabilization plans; and
- to secure access of products in short supply.

However, if one country decides to introduce a restriction on any exports to the other, it must ensure that:

- the restriction does not prevent the other country from having access to the same proportion of the total domestic

supply of that good which it received in the most recent 36-month period prior to the imposition of the restriction;
- it does not use measures such as licenses, fees, taxation, or minimum price requirements to impose prices for exports that exceed prices charged in the domestic market (except where a higher price results from action described in the preceding bullet point); and
- the restriction does not require the disruption of the normal channels of supply.

Significance

The removal of border measures, which ensures enhanced access to the vast U.S. market and which will have implications for market access that exceed any other aspect of the Agreement, so far has received only scant attention. Freeing all Canadian exporters from U.S. border measures represents an increase in access many times greater than would have occurred just by removing the threat of countervailing duties — no matter how desirable the latter would be.

The relation between the GATT and the Agreement is nowhere more clearly borne out than in the arrangements for import and export restrictions. These conditions simply make the two countries' GATT obligations more explicit with respect to bilateral trade. Incorporating them in the Agreement also makes it harder for these rules to be ignored, as often happens under GATT supervision. Because it imposes stringent discipline on the two countries to abide by GATT rules, GATT supporters should welcome this aspect of the Agreement. These conditions, on which there has been much debate, are intended for use in rare cases of emergency (which can be declared to exist at the sole discretion of the exporting country). They have no effect on the normal sales of products during the normal conditions that exist most of the time. The significance of the sharing arrangements to be used under emergency conditions is further discussed in Chapter 9, on energy.

The provisions of Chapter 4, together with those of Chapter 11, have important implications in restricting U.S. (and Canadian) use of voluntary export restraints. This important gain is further discussed in Chapter 11.

Early in 1988, it became clear that the Canadian government intended to help the Canadian clothing industry by instituting a duty remissions scheme. Although such schemes must be phased out by 1988, there is still a ten-year period when they are allowed if introduced before June 1, 1988 (Article 405). The looser rules of origin agreed for clothing mean that Canadian-produced clothing can be exported to the United States even if more than 50 percent of its direct manufacturing cost is made up of imported fabrics. The duty remission scheme means that no duty would be paid on the imported fabrics incorporated in these exports.

A heated controversy then broke out as to whether or not there was any unwritten understanding limiting the use of Canadian duty remissions to aid the Canadian clothing industry. The United States objected that such schemes give Canadian firms an unfair advantage in being able to use duty-free imported fabrics in their exports to the United States. Canada responded that the Canadian clothing industry had always been heavily specialized in adding fashion and design to imported fabrics and that this efficient activity could not prosper if heavy tariffs had to be paid on imported fabrics. After extended discussions, Canada put forward a scheme allowing for $63 million of duty remissions, rather than for $200 million as had been planned.

Concerns

By removing all bilateral trade impediments and by agreeing to rules on sharing whenever the government declares an emergency and then restricts exports, has not Canada effectively ceded the right to pursue independent policies with respect to such national goals as resource conservation?

The answer is no. Under normal market conditions, Canadian resources can be used as required to satisfy Canadian needs. There is nothing in the Agreement that forces Canada to continue exporting a given volume of some commodity just because it was exported in the past. The sharing arrangements have nothing to do with normal shifts in sales as market conditions change. If, for example, Canadian demand slowly expanded to require more of the output of an exported Canadian commodity, newly made contracts would reflect the changing pattern of demand by reducing the amount exported over time.

Furthermore, nothing in the Agreement precludes Canadian governments from requiring that production of any resource-based industry be reduced for conservation purposes. The only thing required is that *if* a government-imposed reduction in output is accompanied by a government-imposed export restriction, the United States must be guaranteed access to the same proportion of the total Canadian supply as it used in the most recent 36-month period. (This constraint is further considered in the energy chapter.)

Does the Agreement require that the price of Canadian exports to the United States be the same as the prices charged in Canada?

Many of those who oppose the Agreement, including some in the highest political quarters, have spread the myth that the Agreement controls the prices at which suppliers can sell their goods. The fact is that Canadian producers, including Crown corporations, *have not* relinquished their ability to charge prices that vary with market conditions and the conditions of supply on both sides of the border. Many commodities, such as oil and electricity, are sold under many different conditions at many different prices, and the Agreement does nothing to regulate the terms of commercial price setting. U.S. prices can be higher, or lower, than prices charged at home — subject, of course, to existing antidumping and other relevant laws. What the Agreement prevents is direct government intervention to impose transborder price discrepancies.

5
National Treatment

Content

Article 501 spells out both countries' obligation to accord national treatment to each other's goods. It prohibits discrimination based solely on national origin, except where the Agreement explicitly allows. Article 502, which is taken from Article III of the GATT, extends this obligation to all provinces and states.

Significance

This short but important chapter ensures that goods imported into either country cannot be put at a competitive disadvantage *vis-à-vis* domestic goods. Understanding the principle stated in this chapter is critical to assessing much of the current debate. As we have already observed, national treatment allows each government to follow any policies it wishes, including those that are totally different from the other government's, with only a single important proviso: that it does not use these policies to discriminate solely on the basis of nationality, either overtly or covertly.

For example, Canada can have high taxes on cigarettes sold in Canada, while the United States has low taxes on cigarettes sold in the United States, *as long as* the high Canadian taxes apply to both U.S.- and Canadian-made cigarettes, while the low U.S. taxes also apply to cigarettes made in both countries. Similar comments apply to standards (Article 603). Canada can require, for example, that all children's clothing sold in Canada be nonflammable, provided only that the restriction applies both to U.S.- and Canadian-made clothing. At the same time, the United States may permit some clothing to be flammable, as long as the rule applies equally to goods made in

both countries. The same principle also applies to investment (Article 1602). Canada can have any policies it wishes, and these can differ by any amount from U.S. policies. Canada can regulate how firms invest, where and how much they produce, and a host of other things, as long as these rules and regulations apply to all firms, irrespective of their nationality.

Concerns

Does the Agreement compel a general harmonization of social and/or economic policies?

In some cases, such as the setting of standards, the Agreement urges *voluntary* harmonization (but does not mandate it). For virtually all broad social and economic policies, however, the Agreement calls only for national treatment, which leaves intact the sovereign right of each country to go its own way on all of its policies, as long as it does not use these policies as disguised barriers to international trade or investment. How unlike the horror stories so often heard that every Canadian policy in sight will have to be harmonized with its U.S. counterpart. (Although we do not quote references here, it is worth noting that a brief survey of the evidence presented to the House of Commons Standing Committee on External Affairs and International Trade and to the Ontario Standing Committee on Finance and Economic Affairs will reveal over a dozen briefs making such arguments.)

6

Technical Barriers

Content

The Agreement precludes the use of standards-related measures as disguised trade barriers (Article 603). Where possible, and where consistent with other legitimate domestic objectives, both countries have agreed to seek to harmonize their standards (Article 604) and to consult on changes to them (Article 607). Chapter 6 does not apply to agricultural goods, food, beverages, and some related goods, nor (unfortunately) does it cover provincial and state regulations regarding standards.

Significance

This chapter uses GATT language, and does little more than give real effect to GATT objectives on technical standards. By doing so, it removes a frequently used, and potent, barrier to bilateral trade.

It also promotes the reasonable coordination of standards, while leaving each country free to impose different standards in pursuit of domestic objectives, as long as these do not discriminate between products solely on the basis of their national origin. Because the states and provinces are not included, the Agreement unfortunately leaves in place some very effective trade barriers.

Concerns

Will Canada and the United States be compelled to adopt common standards on a wide range of policies?

There is widespread belief that the answer to this question is yes. Many who worry about harmonization of standards also

feel that standards in the United States typically are lower than those in Canada and, therefore, that harmonization will lower Canadian standards. One need not debate which country's standards are superior. Suffice it to say that the Agreement makes it clear that standards should be harmonized by mutual agreement whenever both sides see mutual advantage in doing so. Where they do not, harmonization of standards is not required.

7

Agriculture

Content

This chapter contains a host of measures designed to liberalize trade in agricultural goods. Specifically, the two countries have agreed:

- to eliminate all tariffs on agricultural products, phased over a ten-year period (Article 401) and to allow, over a 20-year period, a snapback — or temporary increase in tariffs — on fresh fruits and vegetables under certain conditions (Article 702);
- to prohibit export subsidies on agricultural goods exported to the other country (Article 701.2);
- to remove rail subsidies provided under the *Western Grain Transportation Act* on goods going to the United States through Western Canadian ports (Article 701.5);
- to exclude each other from the provisions of their respective meat import laws (Article 704);
- to allow U.S. grain and grain products access to Canadian markets when, and if, the level of U.S. support equals or falls short of Canadian support (Article 705);
- to allow unlimited access to the U.S. market for Canadian companies exporting products containing up to 10 percent sugar (Article 707); and
- to work toward the harmonization of technical regulations and standards for food, beverages, and certain related products (Article 708).

Significance

The provisions in this chapter go beyond the GATT, EFTA, and the EC-EFTA[1] agreements in liberalizing trade in agricultural products. Given the prior expectation that agriculture would be wholly excluded from the Agreement, this chapter can be regarded as a triumph. The length of the chapter does not reflect any great complexity in the provisions but, rather, both countries' desire to remove any ambiguity in the details.

Article 701.4, which states that each country will take into account the interests of the other when subsidizing the export of agricultural goods to third markets, might be of long-term importance — although no contractual obligation is involved, and there is no recourse to compensation or dispute settlement. The United States has already violated the spirit of this part of the Agreement by selling subsidized grain, oil seeds, and milk to some of Canada's traditional customers. Indeed, both countries probably will violate this article routinely, which suggests that under present arrangements, agricultural export subsidies can only be dealt with effectively through the multilateral negotiations now under way in Geneva as part of the Uruguay Round of the GATT.

The Agreement allows, as does the GATT, the continued use of import quotas to support supply management of such goods as chickens, turkeys, eggs, and milk. (Without such quotas, the high prices that supply management schemes cause would produce a flood of imports.) By retaining supply management schemes and their associated high prices while removing tariffs on manufactured food products, the Agreement appears to threaten Canadian food processors, which must compete with U.S. firms that are able to buy lower-priced U.S. inputs. The problem is somewhat less severe than is commonly assumed, however, since most processed foods that contain a large

[1]The EC-EFTA agreement, struck in 1972, involves a series of bilateral free trade pacts between EC and EFTA member countries. Although negotiated bilaterally, the agreements are virtually identical, including, for example, common rules of origin. They differ only in the schedules for the phased elimination of tariffs.

amount of supply-managed products — for example, chicken nuggets and dairy products — are already under quota. The remaining problems are being alleviated to some extent by the long overdue removal of the two-price wheat system, and by the appropriate allocation of quotas on the import of supply-managed products to food processors that face U.S. competitors. Nonetheless, many observers predict a contraction in the Canadian food-processing industry. Evidently, Canada faces a policy tradeoff between holding agricultural prices high through supply management and keeping Canadian food processors fully competitive by allowing the free market to determine agricultural prices.

U.S. sugar restrictions are quite severe, and the exemption of Canadian food products containing up to 10 percent sugar is a significant gain in access for some lines of processed foods.

As well as setting up free trade in a number of agricultural products, this chapter of the Agreement may have an important signaling effect. For the first time, two major producing countries have sat down at the bargaining table and attempted to reach agreement on these difficult issues. This chapter could form a model for the GATT negotiations — especially since major progress is expected on harmonizing standards, which is a huge issue in food trade. Also, some of the formulas that the Agreement adopts for determining support levels — based on "producer subsidy equivalents"[2] — could form an important basis for the GATT negotiations.

Concerns

Does the Agreement force Canada to abandon the use of such supply management regimes as marketing boards?

It is surprising that some critics still assert that the answer is yes. Instead, the wording of the Agreement is clearly

[2]Producer subsidy equivalents represent the direct subsidies required to replace all agricultural support programs while leaving farm income unchanged — that is, the dollar value of all transfers by direct and indirect programs.

consistent with GATT practices in allowing the use of import quotas that are necessary to support domestic supply management.

Some people have argued that, although the Agreement does not mandate the end of supply management, post-Agreement economic pressures will force this result. These pressures will come from the food-processing industry, and their strength will depend on the extent to which the competitive position of firms in this industry is eroded. This, in turn, will depend on how much the various measures discussed above offset the loss of tariff protection. Some tension will no doubt be set up, and policy choices will have to be made. Although many economists urge eliminating supply management schemes, it seems much more likely that *ad hoc* measures will be sought to help the food-processing industry cope with the competitive disadvantage of high, supply-managed prices.

8

Wine and Distilled Spirits

Content

Article 801.2 exempts provincial liquor boards from the obligation to provide national treatment, except as specified below. Articles 802, 803, and 804 prohibit liquor stores from using price lists or distribution facilities as disguised barriers to trade. Articles 805 and 806 remove some minor bilateral irritants about liquor blending and product standards.

Significance

Current practices of provincial liquor boards, which are used to protect Canadian wine producers, will be phased out — over a period of seven years in the case of wine-pricing policies. The provincial boards will be able to charge higher prices for U.S. products, reflecting the (higher) actual cost of marketing these goods (Article 803.1). Canadian distillers stand to gain from the Agreement since the removal of U.S. tariffs (under Article 401) will enhance their access to the U.S. market. Duties on Canadian Whiskey entering the United States will be dropped January 1, 1989, while duties on wine and other distilled spirits will be phased out over ten years.

On wine sales policies, the changes called for by the Agreement are similar to those required by the recent GATT judgment against Canada. So, for those who support the GATT, the only difference the Agreement makes is in the timing of the removal of trade barriers on wine.

Lower-grade wines will be in the most difficulty. Major adjustments will be needed, and the industry may shrink in size. Higher-grade wines, however, are often internationally competitive today. There is reason, therefore, to expect that the

higher grades of Canadian wines will be able to compete with U.S. wines of similar quality.

Because the sale and distribution of wines and distilled spirits is under provincial, not federal, jurisdiction, the federal government will have to use its best efforts to get the provinces to comply with the terms of the Agreement. This may prove difficult, given some provinces' disapproval of the whole Agreement.

The provinces also use measures to protect inefficient local beer production. The Agreement leaves these measures in place and so leaves consumers facing high beer prices and a restricted range of choice. A recent GATT judgment, which ruled against provincial liquor board practices, gives Canada until the end of 1988 to report to the GATT on how it plans to comply with the ruling. At this stage, the federal government appears willing to accept the international trade ruling on wine and distilled spirits, but to ignore the aspects that affect beer. Defiance of a GATT ruling, of course, opens Canada to retaliatory actions against Canadian exports.

Concerns

Will the Agreement have an adverse effect on the Canadian wine industry?

Major adjustments certainly will be required. The existing structure of the industry is only maintained by protectionism that conflicts with Canada's GATT obligations. So a restructuring of this industry is inevitable in any case, whether it takes place because of the Agreement or the GATT. The only way to prevent this restructuring from taking place is to reject the Agreement and to renege on Canada's GATT obligations — something that no one who supports trade liberalization would wish to occur.

9

Energy[1]

Content

The provisions of this chapter have been the subject of considerable discussion. The chapter covers a large number of energy products (Article 901), including coal and coal gas, crude oil and petroleum products, natural gas, uranium, electricity, and liquified petroleum gases such as propane, butane, and ethane. It *does not* cover water.

In Article 902, the two countries reaffirm their rights and obligations under the GATT on the regulation of trade in energy products. This includes a prohibition on setting minimum prices for exports and imports, except where required to enforce antidumping or countervailing duty measures.

In Article 903, the two countries agree not to impose any type of export tax or duty on energy. Export taxes — the most straightforward method of discriminating against foreign purchasers — are inconsistent with free trade.

Article 904 is an exact restatement of Article 409, as it applies to restrictions on exports of energy products to the other country. These are allowed when they are justified under GATT rules, provided:

- that any imposed restriction does not prevent the other country's access to the same proportion of the total domestic supply that it received in the most recent 36-month period prior to the imposition of the restriction;
- that neither country uses measures such as licenses, fees, taxation, or minimum price requirements to impose prices for

[1]Our analysis of this chapter of the Agreement relies heavily on Edward A. Carmichael, *Energy and the Canada-U.S. Free Trade Agreement*, Trade Monitor no. 4 (Toronto: C.D. Howe Institute, 1988).

exports that exceed prices charged in the domestic market (except where a higher price results from actions described in the preceding bullet point); and
- that the restriction does not require the disruption of normal supply channels.

Article 905 provides both countries with the right to formal consultation over any changes in regulatory policies that distort energy trade. Article 906 recognizes the importance of oil and gas fiscal incentives for maintaining reserve levels. This does not constitute an exemption from countervailing duties, but it does provide both countries with some leeway in encouraging exploration and development.

Article 907 defines "national security" much less broadly than under the GATT.

Article 908 states that the Agreement is not inconsistent with the goals of the International Energy Agency (IEA — see Box 4) and that commitments made through the IEA supersede those contained in the bilateral Agreement. This is an important assurance to other IEA members that Canada and the United States will live up to their international commitments on energy. This includes the oil-sharing arrangement under the IEA, which is considerably more onerous than the proportional-sharing arrangement contained in the Canada-U.S. Agreement.

The energy chapter also contains important appendices that:

- exempt Canada from the U.S. prohibition on exports of Alaskan oil, up to 50,000 barrels per day;
- eliminate U.S. restrictions on the enrichment of Canadian uranium;
- exempt the United States from Canada's requirement that Canadian uranium be upgraded before it is exported; and
- require the U.S. Bonneville Power Administration to afford British Columbia Hydro fair access to its distribution lines.

Box 4

The International Energy Agency and the Sharing of Scarce Oil

The International Energy Agency (IEA) was established in 1974 within the framework of the OECD. It has 21 members, including Canada and the United States. Among its goals is an arrangement to share the collective oil supplies of all member countries in the event of an emergency that causes a reduction of 7 percent or more in the oil supply to one or all members.

Available supplies are to be allocated in such a way as to ensure that, when supplemented by emergency stocks, each country will receive sufficient oil to sustain at least 90 percent of normal consumption. In times of declared shortage, measures to restrain domestic demand are mandatory. If a country loses enough net oil imports, it will get an "allocation right" to existing members' supplies. If it supplies in excess of its domestic needs, it will be bound by an "allocation obligation" to offer such supplies to members in need.

Significance

Essentially, all this chapter does is to embed the articles of the GATT, with a few extensions, into a more obligatory document, making it explicit that these obligations cover energy products. In fact, Articles 902, 903, and 904 of this chapter are exact copies of Articles 407, 408, and 409 of Chapter 4, with the substitution of "energy good" for "good". All of the products covered, with the exception of electricity, are also covered by the GATT. In the case of oil, the Agreement makes fewer commitments on the sharing of supplies in the case of an emergency than does the IEA. As far as Canada's commitments under the IEA are concerned, the Agreement merely states that should they come into conflict with any provision of the Agreement, Canada's IEA obligations will take precedence.

The inclusion of trade in electricity places it under GATT-like rules for the first time — since electricity is not covered by the GATT itself. Since U.S. coal interests have been threatening protectionist actions against Canadian electricity, its inclusion would appear to be a clear benefit to Canada. Because it is excluded from the GATT, no appeal against any U.S. protectionist action on electricity is available through GATT dispute settlement procedures. It will, however, become available through the Agreement's bilateral dispute settlement mechanism.

Some critics see the "proportional-access" rule as the Achilles heel of the Agreement. On closer examination, however, it turns out to be little more than a sharing principle to which Canada and 101 other countries are already committed under the GATT, and somewhat less than that to which Canada and 20 other countries are already committed under the IEA.

What does "proportional access" mean? First, as long as markets continue to function freely, so that supply and demand remain relatively balanced, the proportional-access rule will have no effect. This is because it is only applied if the exporting country (Canada) decides it wants to impose export controls. Canada could decide, for example, to restrict production because its reserves of crude oil were diminishing. *If* it wished to accompany these production restrictions with restrictions on exports to the United States, it could do so only in the same proportion as the restriction on total production.

The national security clause is a benefit to Canada since, in the case of energy, national security is often the battle cry of U.S. energy producers when they face competitive imports. Under the new, tighter definition, the United States would be able to invoke national security to restrict imports of Canadian energy only if it faced a genuinely severe military threat.

The Agreement will provide stability and confidence that free trade in energy will last. Investors can then make their decisions based on the knowledge that the rules will not change. They will also know that large, high-cost projects that

only make economic sense if a large market exists are now more likely to be viable.

Let us now look briefly at the significance of the Agreement for key energy exports: uranium, crude oil and natural gas, and electricity.

Uranium

Canada's uranium industry is a winner under free trade. Canada is the world's largest exporter of uranium. U.S. uranium producers have used both political action and legal proceedings in attempts to restrict the use of foreign uranium. A case before the U.S. Supreme Court in early 1988 threatened to result in a total embargo on all uranium imports. If this occurred, whether as a result of this case or some other action, Canada would lose a market worth $400 million, with most of the impact being felt in northern Saskatchewan. Under the Agreement, Canadian uranium will be exempt from any import restrictions. In the short term, this will maintain an important market; in the longer term, it will greatly enhance the development potential of the Canadian uranium industry.

Crude Oil and Natural Gas

The battles of the 1970s and early 1980s between the federal government and the producing provinces over prices, royalties, taxes, and export restrictions damaged the industry. Under the Agreement, Canadian governments will no longer be able to intervene to set export prices above domestic energy prices, as the federal government did after 1973 and again in 1980 with the National Energy Program. The use of export restrictions, export taxes, and minimum export prices, all features of government energy policies in the 1970s, either will be ruled out or severely restricted. During the 1970s, Canada's energy policies clearly were inconsistent with its GATT obligations and strained relations with the United States. The United States was also violating some of its GATT energy commitments, so it never challenged Canada's policies in the GATT.

By the early 1980s, most countries had recognized that two-price policies were inefficient as well as regionally divisive. Raising domestic prices to world levels played a key part in ending the energy crisis by encouraging an economical use of energy. Indeed, most economists now advocate selling scarce energy at a price that reflects its true, world market value. Canada's oil and gas industry and the producing provinces see an agreement that prohibits Canada from repeating its past energy policies as a major gain. Those who wish to preserve the freedom to experiment with two-price systems in the future see the Agreement as a loss.

Electricity

Trade in electricity has always been free of tariffs. As Canadian exports increased substantially in volume after the mid-1970s, however, the threat of U.S. protectionism increased. The inclusion of electricity in the Agreement, therefore, comes at a time when the industry is entering a phase in which its future rate of growth will depend significantly on secure access to the U.S. market.

Concerns

Under the energy provisions of the Agreement, is Canada prevented from using its abundant supplies of oil to subsidize Canadian industry by selling oil in Canada at a price below the world price?

Indeed, this is one of the major policy limitations imposed by the Agreement. The argument for rejecting the Agreement because of this limitation is that Canada should be free to use its abundant energy supplies to benefit its manufacturing industries and consumers by supplying them with energy below the world price. Even if current opinion is against this policy, surely it should not be ruled out for use by future governments with different political views and operating in different economic climates.

The argument for accepting the limitation is that forcing the domestic price of energy below the world price is not a sensible policy. It encourages waste and discourages the development of new sources of supply. It is also nationally divisive because it forces the energy-producing provinces to subsidize the energy-using ones. Furthermore, alternative tools are available to satisfy any goal of policy that could be achieved by the two-tier price system. For example, energy can be taxed, and the tax revenues used in any desired way for the benefit of consumers or firms. So, to supporters of the Agreement, accepting this limitation on a policy that they see as economically ill-advised, regionally divisive, and that has alternatives, is a reasonable price to pay for the security of access to the U.S. energy markets that the Agreement provides.

Does the proportional-sharing arrangement give the United States preferred access to Canada's resource supplies?

Under normal circumstances, Canadian resources will be sold on the open market to all comers without preference. Any sharing comes into force only if Canada wishes to proclaim an emergency and then restrict both domestic output and exports to the United States.

Does the proportional-sharing arrangement stop Canada from having an independent energy policy on such matters as the conservation of scarce supplies of natural resources and the appropriation of resource rents[2] when these are high?

To answer this question in the affirmative is to perpetuate a fallacy that has found its way into high-level political documents and speeches, editorials, and op-ed pieces.

To understand the significance of the proportional-sharing rule, one must understand:

[2]Resource rents refer to revenues earned by resource industries that are in excess of what is required to repay all expenses of development and exploitation and to yield a "reasonable" return on capital invested. In times of scarcity, resource revenues can rise to very high levels, yielding large resource rents for existing producers.

- that under normal conditions, the sharing rule will not be invoked;
- that it is Canada that determines if, and when, this rule will be invoked;
- that Canada is under no obligation to sell any particular quantity to the United States as long as it provides U.S. buyers with access to the required proportion of Canadian supply at commercial terms; and
- that Canadians can continue to compete in the open market to buy any amount of Canada's energy supplies up to the total amount available.

The Agreement does not appear to deny Canada the use of sufficient policy tools for any rational response to a perceived national problem. In particular, Canadian governments can:

- control the extraction rate of nonrenewable resources, which is the correct response to a government decision that private firms are exploiting the resources too quickly;[3]
- tax oil production, which is the necessary tool to appropriate resource rents whenever the government thinks they are higher than the industry needs; and
- encourage exploration and development of new energy resources using such measures as grants, tax relief, and subsidies.

What Canadian governments cannot do is use these policies as disguised ways of discriminating against foreign-owned oil firms.

Does the energy-sharing arrangement mean that, if a Canadian province sells electricity to a U.S. state, it must continue to do so in the future, whatever the development of Canadian needs?

[3]In technical terms, this occurs when the government believes that the social rate of discount is less than the market rate.

Recent affirmative answers to this question suggest a misunderstanding of the conditions of the Agreement. Canadian electricity — like all other energy products — is sold to the United States under commercial contracts. The sort of sudden emergency that invokes the sharing rule is not the sort of situation that would emerge if the Canadian demand for electricity increased under normal rates of economic growth. If the pattern of Canadian demand changed slowly at rates typical of those caused by economic growth, there is nothing in the Agreement to stop Canadian electricity authorities from reacting by selling a higher proportion of output in Canada while selling a lower proportion to the United States. As old U.S. contracts expire, new contracts would be negotiated for increased sales to Canadian users.

How, then, might the sharing arrangement cause problems for Canada?

Problems could arise if some sudden change caused a crisis of sufficient magnitude to lead the government to wish to restrict energy exports in ways that violated current commercial contracts. One example might be a nuclear disaster that severely disrupted the output of Canadian electricity. U.S. users could not just be cut off, but could have their supplies cut back in proportion to the overall restriction of output. This arrangement would seem to be the kind of guarantee that is needed if Canada is to become increasingly important as a major supplier of energy products to the United States. Although it seems a reasonable, and necessary, price of gaining access to the U.S. market, the vagueness of the arrangement suggests that consultations on how to cope with real emergencies should take place now. The sharing rule says that one country cannot just cut the other off in cases of emergency; it does not spell out in detail what the rational binational policies would be in the event of various conceivable emergencies. These should be worked out now, in advance of such emergencies.

Critics who do not want this arrangement to exist have yet to state their tradeoffs. How much loss of market is worth preserving the right to restrict supplies arbitrarily?

Does the Agreement prohibit policies that are needed for the development of Canadian-based energy industries?

Canada's energy security, and that of the United States, should be enhanced by free trade in energy. The vast potential of Canada's frontier reserves is unlikely to be developed fully to supply the Canadian market alone — a fact that few critics seem to recognize. For many frontier megaprojects to be economically viable, very large volumes of production are required. Undeveloped, these frontier reserves contribute nothing to Canada's energy security or to its economic well-being. If free trade helps bring this energy to market, it will enhance the energy security of both countries.

If the United States adopts policies to make its domestic price of some commodity, such as oil, diverge from the world price — say, through restricting imports from third countries — must Canada be dragged along?

Paragraphs 3 and 4 of Article 902 allow each country to shield itself from the effects of policies implemented by the other and directed against third countries.

Although the Agreement removes visible barriers to energy trade, does it also remove invisible barriers, including regulatory delays and red tape?

The U.S. Federal Energy Regulatory Commission, for example, has used regulatory delays to stall the approval process for the building of new pipeline capacity to transport Canadian natural gas to the U.S. Northeast. While the Agreement cannot guarantee that such invisible barriers will be eliminated, Article 905 does provide a consultative mechanism for disputes over them — a mechanism that did not exist before.

Either country can initiate direct consultations with the other, if any energy regulatory action would result directly in discrimination against its energy goods or would be inconsistent with the principles of the Agreement. Consultations would involve, in the case of Canada, the Department of Energy, Mines and Resources, and in the United States, the Department of Energy.

Does the Agreement require that Canada sell its water resources to the United States, possibly even by diverting the flow of its rivers southward?

The myth that the answer to this question is yes continues to be stated in the highest political quarters. In fact, the Agreement says nothing about water. No doubt the time will come when the United States will look to Canada as a source of increasingly scarce water. Canada's response then will lie in Canadian hands and will not be constrained by the Agreement in any way.

10

Automotive Products[1]

Content

In line with the general terms of the Agreement, all tariffs on new vehicles and parts (Article 401), and the Canadian embargo on the importation of used cars (Article 1003), are to be phased out in five steps. Duties on after-sales repair parts and tires will be removed in ten steps.

Significance

This chapter amends the rules of the existing Canada-U.S. auto pact and then embodies them in the Agreement. The significance of this is hard to grasp without a working knowledge of the terms of the auto pact. For this, we refer readers to Boxes 5 and 6, which are based on similar boxes in the *Trade Monitor* cited in the footnote below, and to the rest of Wonnacott's study.

Changes to the auto pact are probably best understood by dividing producers into two categories: those that will continue to have full auto pact status, and those that will not.

According to Article 1001, any firm with auto pact status (including the Big Three), will continue to qualify for the duty-free import of cars and parts from anywhere in the world. This privilege is contingent on meeting the production safeguards described in Box 5. To export duty free to the United States, these firms must also adhere to the new origin rule, which calls for at least 50 percent of the direct production costs to be incurred in Canada and/or the United States. This rule replaces the old 60-percent-of-invoice-value requirement, which included overhead costs in the invoice price.

[1]The discussion presented here relies heavily on Paul Wonnacott, *The Canada-U.S. Free Trade Agreement and Auto Pact*, Trade Monitor no. 2 (Toronto: C.D. Howe Institute, 1988).

Under the Agreement, no new member can be admitted to the auto pact after 1989, and so no new firms will qualify for duty-free imports into Canada from any third country (Article 1002).

It is not at all clear that the Agreement leaves firms that are not members of the auto pact — such as Hyundai, Toyota, and Honda — better off. On the one hand, they will enjoy duty-free access to the U.S. market providing only that they meet the rule of origin. They will also be given production-based duty remissions until the end of 1995. After that date, however, they will have to pay duty on parts and cars imported from third countries, while auto pact producers will still be granted duty remissions.

The auto pact does not appear to have been weakened in any serious way; to the contrary, it seems to have been made even more favorable to North American producers than it now is. Both the elimination of duty drawback and the move from the old domestic content rule of 60 percent of invoice value to the new rule of 50 percent of the direct manufacturing cost raise the protection provided for Canadian and U.S. auto parts firms. Parts manufacturers have exerted significant pressure to raise the requirement to 60 percent, but this change seems unlikely.

Free traders will worry that the elite status of auto pact firms is retained while nonstatus players are left to face global competition. The essential nature of the auto pact, however, does not seem to have been changed.

Concerns

Does the removal of tariffs on all Canadian-U.S. trade remove the incentive to adhere to the domestic production safeguards, because the sanction of abrogating tariff remissions on such trade will no longer be possible?

Once there are no duties payable on Canadian-U.S. trade in autos and auto parts, the threat of removing the privilege of

Box 5
The Auto Pact of 1965

The auto pact provides duty-free entry of new autos, most commercial vehicles, and most original equipment (excluding tires and tubes), provided certain conditions are met.

On the *U.S. side*, duties were eliminated only on imports from Canada, and the auto pact is thus a preferential agreement. In order to prevent transshipment of overseas cars and parts through Canada into the U.S. market, the United States permits duty-free entry only to products meeting an origin rule — in this case, the rule was that 50 percent of full invoice cost should be North American content. Because the United States granted such treatment to Canada, it violated the most-favored-nation clause of the GATT. The United States accordingly obtained a GATT waiver for the auto pact.

On the *Canadian side*, the privilege of duty-free entry was granted on imports from all countries provided that the manufacturers conformed to the following series of "production safeguards":

- they had to maintain the pre-pact ratio of Canadian production of vehicles to their Canadian sales of vehicles (and, in any case, not less than 75 percent); and
- they had to maintain, in the production of vehicles in Canada, Canadian content equal to that in the 1964 model year. (This condition was significant only during the early years of the pact.)

duty remissions on that trade no longer applies. However, the Agreement retains duty remissions on parts and vehicles imported from third countries by auto pact members. At stake to the Big Three auto producers is the $300 million they save annually on duties that they otherwise would have to pay on imports from overseas sources. As Wonnacott notes:

> It is true that an even stronger incentive will be eliminated — namely, the threat of the huge duties that would become payable on imports into Canada from the United States in

Box 5 - continued

In addition, Canadian automobile producers submitted "letters of undertaking" to the Canadian government, committing themselves:

- to increase Canadian value added by at least 60 percent of the growth in their Canadian sales, plus an additional $260 million by the 1968 model year.

Note that this last safeguard is a value-added requirement, *not* a content requirement. The Canadian value added can be exported, rather than just being sold at home. By replacing the content requirement with a value-added requirement, the auto pact allowed Canadian producers to specialize on longer, more efficient production runs.

Under the pact, a manufacturer meeting the safeguards can import duty free into Canada *from any country*. Thus, Canada did not grant the United States a preference, and was not required to seek a GATT waiver. The safeguards provide Canadian producers with protection from non-Canadian products, whether from overseas or from the United States. The right to import duty free from any country is inseparably linked to the safeguards. If there were no safeguards, the Canadian auto tariff would be applied to overseas producers; otherwise, it would be meaningless. Put another way, the safeguards are enforced by the duties that would have to be paid if they were not met.

> the event that auto firms failed to meet the Canadian assembly safeguard. But one may ask whether this threat could be carried out in practice. Like an atomic weapon, it may be too powerful to use. Before Canada presented auto firms with huge duty bills on imports from the United States, serious thought presumably would have to be given to the danger of U.S. retaliation....A more modest weapon — duties on imports from overseas — is more usable, both because of its size and because it does not apply to exports from the United States.[2]

[2]Ibid., pp. 9-10.

Box 6

How the Free Trade Agreement Changes the Auto Pact

The Canada-U.S. Free Trade Agreement leaves most of the auto pact undisturbed, with three notable exceptions:

- There will be a phased elimination of remaining duties on Canadian-U.S. automotive trade, including duties on tires and replacement parts.
- The basis for calculating 50 percent North American content is redefined, resulting in an effective increase in that requirement. Instead of 60 percent of the invoice value having to be North American content, 50 percent of direct manufacturing costs must be North American.
- After the 1989 model year, the auto pact will be closed to new members; no new firms will be able to qualify for duty-free imports into Canada from third countries. A firm remaining outside the pact will be treated like a nonautomotive company. It will pay duties on materials and components imported into Canada from third countries, and it will be able to export products duty free to the United States if they meet the 50-percent-North-American-content rule. Similarly, the firm will be entitled to import parts duty free from the United States

It should also be noted that by being incorporated into the Agreement, the auto pact becomes less vulnerable to abrogation, or amendment, than it was when it stood alone. For these reasons, the commonly heard allegation that the Agreement "gutted" the auto pact appears difficult to sustain.

Will the ending of duty remission schemes make it harder for Canada to compete with the United States in attracting the next round of investment by offshore auto firms?

There are two elements involved in this discussion. First, Canadian export-based, duty remission schemes have been a source of friction between the two countries. Canada sees them as providing an important incentive for overseas firms to

Box 6 - continued

if they contain 50 percent North American content. (Note that in this context, "North American" means Canada and the United States; it does not include Mexico.)

The first change means that the biggest stick enforcing the safeguards will be phased out. After this is completed in 1998, U.S.-owned firms operating in Canada will no longer face the prospect of having to pay duties on imports from the United States if they fail to meet the safeguards. However, they will still face duties on their imports from overseas. As argued in the text, the smaller stick of a threat to have to pay duties on imports from overseas is more credible than the large stick of a threat to have to pay duties on all Canadian-U.S. trade. On the Canadian side, an important aspect of multilateralism remains: current auto pact firms that meet the safeguards will still be able to import duty free from any country.

The second change increases the protection given to North American parts producers by effectively increasing the North American content required to meet the rules of origin.

The third change represents a significant departure from equal multilateral access to the Canadian market. Present members are predominantly U.S. (although Volvo is included); those who will be excluded are predominantly foreign.

invest in this country; the United States views them as subsidies. There was a real danger that U.S. producers would react to these with a countervail case. So, ending remission programs to non-auto-pact firms might have been required in any case.[3] Second, the United States beat Canada in the original round of competition to attract offshore investment because of factors unrelated to economic considerations. As Wonnacott notes:

> This choice of U.S. over Canadian sites was not simply the result of market forces. The Japanese were responding to

[3]This is the theme of Wonnacott's study.

> political pressures in the United States, and the establishment of plants in Canada would have done little to ease their political problem south of the border.[4]

So, in the next round of investment by offshore auto firms, in the 1990s, Canada will no longer have the carrot to attract these firms. But neither will the United States have the credible threat of undertaking countervail actions against Canadian practices. Therefore, offshore investment will tend to locate in the country with the most competitive cost structures, all else being equal. In this event, Canada should be able to compete in attracting this investment by virtue of its competitive production costs.

If the Agreement is rejected, can we expect the present auto pact to be retained?

Some commentators have argued that the auto pact should not have been included in the Agreement since "it wasn't broken" — that is, its present condition was satisfactory. But, as Wonnacott suggests, "the auto pact was broken, although in subtle and complex ways."[5] In its present form, the future stability of the pact is uncertain, since the threat of U.S. countervail hangs over such Canadian auto policies as duty remissions. The status quo of the present auto pact is probably not sustainable. Those who oppose the changes offered in the Agreement should lay out the changes they feel could be negotiated outside the Agreement and then compare these with Chapter 10 of the Agreement.

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[4]Ibid., p. 5.
[5]Ibid., p. 1.

11

Emergency Action

Content

Chapter 11 sets out the details that provide for the temporary use of emergency safeguards.

According to GATT rules, if a country suffers a temporary surge in imports of some product, it can take emergency action to limit the imports of that product in order to safeguard its domestic producers. Specifically, GATT Article XIX permits global emergency actions — both surtaxes and quantitative restrictions — to restrict imports from all sources when they increase sufficiently to cause "serious injury" to domestic producers of similar or directly competitive goods.[1] This was the route the United States took to levy a 35 percent tariff on Canadian shakes and shingles in 1987.

Bilateral emergency action refers to trade restrictions levied by Canada or the United States on imports of some product from the other country. Global emergency action refers to the restriction of imports of some product from all foreign sources.

Bilateral Emergency Action

During the ten-year transition period — that is, before all tariffs are eliminated — the Agreement allows either country to impose *temporary* tariff measures to protect injured domestic producers. The use of these safeguards is conditional on the following stringent criteria (Articles 1101.1 and 1101.2):

- the injury must be a consequence of the reduction or elimi-

[1]GATT rules define serious injury as a situation whereby foreign imports cause a significant decline in domestic production, losses of sales, losses of market shares, declining profits, and so on. The rules require emergency safeguard measures to aid the offended industry.

nation of a duty as required by Chapter 4, and imports from the other country alone must be the substantial cause of that injury;
- before either country takes action, it must notify and consult with the other country;
- no action taken can last longer than three years, and can only be taken once for any particular good;
- once the action has expired, the tariffs must continue to be reduced or eliminated as if the action had not happened; and
- compensation must be given to the country against which the action was taken.

After the transition period has expired, neither country can take a bilateral emergency action *without* the consent of the other (Article 1101.3). This clause permits emergency action only for injury resulting from the reduction or elimination of tariffs under the Agreement — in other words, a tariff response to a tariff problem.

Global Emergency Action

Article 1102 alters Canadian-U.S. relations with respect to global emergency action taken under GATT rules. The Agreement retains each country's rights and obligations under the GATT, but changes these requirements to make them consistent with the intent of the bilateral arrangements. Most importantly, Canada is freed from U.S. global action aimed at other countries. This is because any global action that either country takes *must exclude* the other unless imports from the other country are substantial and are contributing to the injury. Article 1102 indicates that imports in the range of 5 to 10 percent, or less, of total imports normally would not be considered as substantial. If the other country is initially excluded from the emergency action, it may be brought under the action subsequently if imports from that country surge so as to undermine the effectiveness of the original action.

Before either country can take any global action to restrict an import from the other country, prior notification and consultation is required. If one country takes action against shipments from the other, the imposed reduction in imports from that country cannot be reduced below the trend of imports over a reasonable recent base period — for example, the most recent 36-month period for which statistics are available — with allowance for growth (Article 1102.4). Compensation must accompany any emergency action that is taken by the importing country. (Article 1102.5)[2]

Article 1103 states that any unresolved disputes arising from this chapter must be settled by binding arbitration.

Significance

Since present U.S. emergency safeguard actions are consistent with GATT rules, Canada cannot obtain relief from them through the GATT. The Agreement, however, provides a major improvement over these practices in the following ways:

- Canadian negotiators will no longer have to plead for exemption from global measures directed at other countries — thus ending the so-called sideswipe problem;
- notification and consultation makes unilateral, politically motivated action more difficult;
- the compensation clause diminishes the temptation to take action against injuries that are not perceived to be important;
- the clause limiting the severity of the emergency action that can be taken allows investors to make location decisions with the assurance that their exports will not be rolled back if they are successful in rapidly penetrating the other country's market (Article 1102.4b); and
- the United States' ability to demand that Canada accept VERs will be much reduced, since it will no longer have an effective stick (quotas) to use if Canada chooses to resist the demand.

[2]The precise definition of compensation is given in the Glossary.

This last point deserves elaboration, since it is an important gain for Canadian exporters. Under the status quo, the United States can use the credible threat of imposing quantity restrictions on any Canadian exports in order to induce Canadian producers to accept VERs. For example, Canadian steel producers recently have been voluntarily curtailing their exports to the United States in order to avoid the overt imposition of quota restrictions by the U.S. government. Articles 407, 1101, and 1102 remove Canadian exporters' motivation to comply with U.S. requests for VERs, since the strategy of using quotas as threats will no longer be credible — quotas are prohibited except in specified and quite limited circumstances. Canadian producers will not have to restrict exports to the United States, except when these exports are demonstrated to cause serious injury to U.S. competitors — that is, when the United States takes bilateral or global action, and Canada is the main reason for the action being taken.

Concerns

There are no concerns to discuss, nor myths to dispel, with respect to this chapter. It is such a dramatic and unequivocal improvement over present practices that opponents of the Agreement have chosen to ignore it. It guarantees access to the U.S. market for fairly traded Canadian exports, no matter how successful they become.

12

Exceptions for Trade in Goods

Content

This chapter incorporates the provisions of GATT Article XX. It permits the use of certain measures to control imports and exports where they are justified by such considerations as the need to protect public morals, human, animal, or plant life, and national treasures of artistic and/or historic value.

Article 1202 grandfathers any measure, law, or regulation that was grandfathered under GATT Article II. The most important policy that this Article sweeps up is the grandfathering of the U.S. *Jones Act*, which provides for the protection of the U.S. shipping industry by requiring that imports to the United States passing through U.S. ports be carried by U.S. vessels. (As a result, Canada has retained the right to do the same through Chapter 4.)

Article 1203 contains contains a list of measures that are explicitly exempted from the articles affecting trade in goods, including:

- controls by either country on the export of logs of all species;
- controls by Canada on the export of unprocessed fish on the East Coast; and
- measures related to the internal sale and distribution of beer.

Significance

Free traders will approve of none of these measures. However, the three points under Article 1203 represent bargaining victories for Canada, while the inclusion of shipping under Article 1202 is a U.S. bargaining victory. Such is the power of the U.S. shipping lobby that not only does the Agreement grandfather the *Jones Act*, it also protects the right of the United

States to pass new legislation that violates national treatment with respect to maritime shipping.

Concerns

Is it true that the Americans out-bargained the Canadian negotiators?

In our view, Canadian bargainers performed extremely well. We have resisted drawing up a balance sheet of bargaining-table victories, although we do not doubt what the outcome would be. This chapter illustrates, however, the typical balance of bargaining victories: the United States won some, and Canada won some. In this case, the United States won one and Canada won three, but the U.S. victory over transportation probably counts for more than any one of the Canadian victories. It should also be noted that a bargaining victory is not necessarily an economic victory. A victory for protectionism is usually a loss for consumers.

13

Government Procurement

Content

All three levels of government in both countries purchase large quantities of goods and services. This is referred to as "government procurement".

Article 1304 opens federal procurement of goods (but not services) to foreign competition on all contracts exceeding a threshold level that has been lowered from U.S.$171,000 to U.S.$25,000. The Agreement covers an extensive list of government departments and agencies on both sides of the border. The few exceptions include purchases made by the Departments of Energy and Transport on the U.S. side, and by the Departments of Transport, Communications, and Fisheries and Oceans on the Canadian side. Both countries' defense departments are also included, but with limited coverage.

The Agreement does not open up markets for procurement by provincial, state, or local government departments and agencies. It thus does not cover provincially owned public utilities and Crown corporations.

By establishing a set of rules relating to bidding, Article 1305 imposes strict discipline on the tendering of contracts. An impartial reviewing authority will arbitrate any bidding challenges.

In Article 1307, both sides stand committed to pursue multilateral liberalization of procurement in the Uruguay Round of GATT talks. Not later than one year after the conclusion of that round, the two countries will negotiate to improve and expand bilateral provisions on procurement.

Significance

Canadian exporters of a wide range of goods, from military hardware to urban transportation equipment, have long wanted access to the U.S. government procurement market. In light of their expectations, this chapter is a disappointment. It opens up only about Can.$4 billion of U.S. procurement to Canadian competitors, out of a total Can.$700 billion U.S. federal, state, and local procurement market. Nevertheless, on the principle that the best should not be made the enemy of the good, there is no reason for turning down a modest but real gain because more was wanted.

Article 1305 may, however, prove to be something of a breakthrough. By requiring that procedures relating to covered procurement items be "equitable, timely, transparent and effective," procurement should be rendered less subject to political pressures, even where foreign bids are not involved.

Concerns

The gains contained in this chapter are not large, but they are useful. The chapter contains no losses. Thus, there are neither concerns to discuss, nor myths to dispel.

14

Services

Content

The Agreement's implications for services have been the cause of great concern among groups involved with broadly defined social services.

The first point to notice is that while the Agreement covers many services, it exempts many others. The services that are included in the Agreement are called "covered services". Key "noncovered services", which are exempted from the terms of the Agreement, include transportation, basic telecommunications (for example, telephone service), medical, legal, and child care, and all government-provided health, education, and social services.

Articles 1401, 1402.1, and 1402.2 provide for national treatment in all future government measures relating to covered services, and for their right of establishment (through cross-reference to Chapter 16, on investment). Later sections of Article 1402 provide for exceptions where needed for "prudential, fiduciary, health and safety, or consumer protection reasons." Article 1403 prohibits the use of licensing as a barrier to trade in services, and encourages each country to recognize the other's licensing procedures for those who provide covered services. Article 1406 prevents people in third countries who wish to provide a covered service from gaining access to one country's market by working through the other country.

Significance

This chapter grandfathers all existing measures that do not conform to the principle of national treatment. It simply extends this established principle in *future* government mea-

sures to a list of commercial services provided by private-sector firms operating for commercial gain. This means that neither country can purposely discriminate against nationals of the other country or erect disguised restrictions on them.

It is important to note that the obligations of this chapter are prospective — they do not require either country to change its existing laws and practices. However, any *new* law affecting a covered service must respect the right of national treatment; it cannot be discriminatory in its design.

National treatment in covered services creates no pressures to harmonize laws, rules, or regulations. For example, Canadian governments can require that all travel agents operating in their jurisdiction be bilingual, if this relates to their competence and ability to do their jobs. The United States need not adopt the same policy toward travel agents operating in that country. The only thing that neither country can do is to use required standards to discriminate between Canadian- and U.S.-owned travel agencies operating in one country.

The Agreement's provisions on trade in services offer a framework for incorporating some of the GATT's general principles on trade in goods into the services sector. Trade in services has become such an increasingly important component of bilateral trade that including it in the Agreement was highly desirable. This part of the treaty is genuinely pathbreaking. It may set the tone for further multilateral GATT negotiations.

Concerns

Does the Agreement curtail the right to regulate covered services for legitimate national purposes?

Nowhere in the Agreement is there a compulsion to harmonize Canadian policies on services with those of the United States. The national treatment obligation does not restrict each country's right to have different policies with respect to the same services; it merely prohibits them from using such

policies as disguised trade barriers to discriminate between domestically and foreign-owned firms that provide covered services.

Does the Agreement mandate the harmonization of Canadian and U.S. policies on noncovered services?

The Agreement is clear on this matter. It requires no changes to Canadian policies on noncovered services. On child-care facilities, for example, Canadian governments can:

- have any rules and regulations they wish covering all firms, Canadian or U.S., that provide such services;
- apply different rules to Canadian- and U.S.-owned firms; or
- set up a nonprofit service (under Article 2010) while discriminating in regulatory and funding practices between private and nonprofit child-care centers to the point of prohibiting the latter outright, whether they are Canadian- or U.S.-owned.

Could the provision of universal, nonprofit child care be blocked because private U.S. firms now operating in Canada could use the Agreement to obtain compensation for lost revenues, thus making them eligible for provincial funding even if a province decided only to fund nonprofit groups?

The previous discussion is relevant here. Child care is exempted from the provisions of the Agreement, so provincial governments can discriminate, if they so wish, against U.S. child-care firms, both in their operation and in their regulation. They can also prohibit such firms altogether. Furthermore, Canadian governments are free to subsidize domestic firms, and to deny these subsidies to U.S. firms.[1]

In view of its clear language, the continued assertion by opponents that the Agreement opens the way for child-care services provided by U.S. firms at an undesirable standard is

[1]For a more detailed discussion of this issue, see Katie Macmillan, *Women and Free Trade*, Trade Monitor no. 5 (Toronto: C.D. Howe Institute, 1988).

unfounded. Some people argue that this and many other questions about the Agreement's contents are just matters of opinion. Of course, any treaty contains ambiguities that require subsequent clarification. But if everything were just a matter of opinion, then no international agreement would ever mean anything. In the case of child care and all other noncovered services, the words of the Agreement could not be clearer. They must be assumed to mean what they say: Canadian authorities have total discretion to adopt absolutely any policy with respect to noncovered services.

15

Temporary Entry for Business Persons

Content

This chapter of the Agreement deals with the issue of the crossborder movements of individuals from each country who wish to conduct business in the other country. The Agreement identifies four categories of business travellers: business visitors, traders and investors, professionals, and intra-company transferees.

Article 1502 and its Annex provide for temporary, quick, and unimpeded entry into either country for persons who qualify for general entry (by satisfying normal health and immigration requirements), and who indicate the nature of their business. This means that professionals will be able to earn money directly in the United States, which will open up opportunities for engineers, management consultants, computer system analysts, and many others.

In Article 1503, the two countries are committed to consider further ways to improve the coverage and operation of the new procedures.

Article 1504 provides for reference to the dispute settlement provisions of Chapter 18 in the case of repeated denial of a business person's request for temporary entry.

Article 1506 restricts these access rights to U.S. and Canadian citizens. Landed immigrants and resident aliens are excluded.

Significance

This chapter removes a serious restriction to trade in the form of harassment at the border of salespersons and after-sales service personnel. When the latter are denied easy access — as is often the case today — firms selling goods requiring

after-sales servicing are placed at a severe disadvantage in the other country's market. The Agreement guarantees that access. It also establishes open, *bilateral* methods for settling disputes over denied entry in certain cases, which is a big improvement over present closed, unilateral practices. These changes improve market access considerably.

Canada's cultural community requested, and received, total exemption from the explicit terms of the Agreement. This is not an unmixed blessing. The terms of this chapter could have been extended to performing artists if the cultural community had reached a consensus on the issue. Many Canadian performing artists wish to live in Canada and still have unimpeded access to the lucrative U.S. market — to appear in concerts, plays, and so on. Yet, by being exempted from the Agreement, ordinary performing artists have given up the access they could have had under Chapter 15. In return, they have preserved such measures as the postal subsidy on mass circulation Canadian magazines, and Bill C-58, which prohibits Canadian firms from deducting the expenses of advertising on U.S. border radio and T.V. stations. The benefits of these measures accrue mainly to the owners of broadcasting stations and mass-circulation publications, rather than to the artists they employ.[1]

Concerns

Will the Agreement allow Americans to move freely into the Canadian labor force?

The answer is no. The provisions of Chapter 15 allow U.S. business and service personnel to enter Canada only for *temporary* work that does not make them members of Canada's labor force.

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[1] In an earlier discussion of the effects of Bill C-58, the Institute concluded that "we...doubt that the principal effect of the policy was to support stations that would otherwise have failed." See Richard G. Lipsey and Murray G. Smith, *Taking the Initiative: Canada's Trade Options in a Turbulent World*, Observation no. 27 (Toronto: C.D. Howe Institute, 1985), p. 101.

16

Investment

Content

Since the provisions of this chapter have come under severe criticism, they need to be studied in some detail.

The chapter begins with two main classes of exceptions that outline cases to which the Agreement does not apply. The first class of exceptions consists of financial services, government procurement, transportation (Article 1601), and cultural industries (Article 2005). The second class consists of noncovered services, such as child care, education, and health care. Article 1602.1c, which extends national treatment to the conduct and operation of business services, exempts such noncovered services.

All of the other investment provisions apply to noncovered as well as to covered services. Taken together, these provisions have important implications for noncovered services. Although each country must apply the principle of national treatment to the acquisition and sale of noncovered service enterprises, the Agreement places no restrictions on the ability of governments to regulate these services. For example, they could refuse to license foreign-owned firms in some or all of the noncovered services.

The investment provisions modify slightly the principle of national treatment in that they allow each country to treat investors differently, as long as this different treatment is equivalent in effect. According to Article 1602.8, different treatment can be extended as long as:

- it is no greater than that necessary for prudential, fiduciary, health and safety, or consumer protection reasons;

- it is equivalent in effect to the treatment accorded to domestic investors for such reasons; and
- prior notification of the proposed treatment has been given.

The Agreement grandfathers all existing investment rules, but any new laws, regulations, or practices must reflect the national treatment obligations of this chapter (Article 1607).

No businesses — including Crown corporations — that existed before the Agreement is implemented are bound by the national treatment provisions in Article 1602. Canada can impose any ownership requirements it desires on the sale and acquisition of such enterprises. Furthermore, Article 1602.7 allows Canadian governments to establish Crown corporations at any future time, and to restrict any sale of such corporations to Canadians. Such corporations, however, will have to comply with national treatment provisions when, and if, they are privatized.

Articles 1602 and 1607 establish more liberal rules for the acquisition of firms. At present, neither country reviews the building of new plants by foreign firms. What Canada reviews is the acquisition of one firm by another. A direct acquisition occurs when a foreign-owned firm buys a Canadian-owned firm. An indirect acquisition occurs when a foreign-owned firm buys out another foreign-owned firm that has a Canadian subsidiary. In today's globalized economy, foreign- and Canadian-owned firms constantly make both direct and indirect foreign acquisitions.

According to the Agreement, Canada reserves the right to review direct acquisitions of Canadian firms by U.S.-owned firms, but the threshold value of the company acquired — below which review is not allowed — will be raised in four annual steps from the present level of Can.$5 million to Can.$150 million. Review of indirect acquisitions is to be phased out over the same time period (Article 1607.3). Limitations of review of takeovers will *not* extend to firms in the natural gas, oil, and uranium industries (Article 1607).

Other important changes to Investment Canada rules involve the prohibition of investment-related performance requirements pertaining to local content, import substitution, and the export of a given level of production (Article 1603). However, this prohibition is not extended to performance requirements that are part of conditions attached to subsidies or government procurement (Articles 1601.2b and 1609.2).

According to Article 1605, if an industry is nationalized to achieve some goal of public policy, due process must be followed and fair and adequate compensation paid. Article 1606 states that there will be no restrictions on the patriation of profits or proceeds from the sale of a business except where necessary to implement national policies — for example, to cope with bankruptcy, or to restrict capital movements for balance of payments purposes (Article 2002).

Finally, Article 1608 provides that disputes arising from provisions in this chapter are to be resolved by the dispute settlement provisions of Chapter 18. The one exception relates to Investment Canada decisions on reviewable acquisitions. In these cases, such decisions are final.

Significance

When one thinks of all the heated debate that has surrounded the investment chapter, it comes as a shock to read the actual text. Most of it is concerned with establishing generally accepted rules of international investment that are in the self-interest of any country that is a major foreign investor, as are both the United States and Canada.

Neither country has surrendered any of its sovereignty in maintaining its current set of investment rules. Except for the changes in conditions for the review of takeovers, all investment rules are prospective. Thus, Canada can continue to *tax* foreign entities in a different way than it taxes domestic firms. Furthermore, any new taxation measure is acceptable, provided it does not constitute a means of arbitrary or unjustifiable

discrimination between investors from either country (Article 1609.1).

At the moment, the United States has no rules that discriminate generally against foreign investment — although it does discriminate in specific sectors such as radio and T.V. If it were to establish such rules after January 1, 1989, it would have to exempt Canada by virtue of the Agreement — a not insignificant gain for Canada.

Important further gains for Canada are, first, that the Agreement exempts all Crown corporations from the national treatment obligations and, second, that once national treatment is established, governments are free to regulate business operations in any way they see fit, provided that all rules and regulations apply equally to firms of both countries.

The major restrictions on future Canadian investment policy are the elimination of the review of indirect acquisitions and the raising of the threshold of review of direct acquisitions to $150 million. There is no doubt that Canada has constrained its future policies in accepting these clauses of the Agreement — although Canada still retains a position asymmetrical to that of the United States. The United States cannot review Canadian acquisitions on the grounds that they are foreign, but only on the grounds that they may not meet national treatment requirements.

Just how much did Canada give up? Giving up the right to review indirect acquisitions would not seem to compromise any legitimate national objectives, since such investments are already owned abroad. The following points suggest that giving up the right to review direct, middle-sized acquisitions may not be a major policy restriction:

- since its inception, Investment Canada has not turned down a single case in the $5–150 million range;
- about three-quarters of total nonfinancial capital in Canada is still reviewable under the terms of the Agreement, and

this includes all of the large takeovers that usually become the object of national concern;

- Canada is now a major foreign investor and, as such, its national interest lies more in establishing fair rules of national treatment for Canadian firms investing in the United States — either through takeovers or the establishment of new U.S. subsidiaries — than in restricting foreign capital coming into Canada.

Concerns

Has Canada given up its ability to regulate investment in pursuit of national policies?

The Agreement still permits any investment regulation, provided it follows national treatment. Furthermore, the Agreement *does not* restrict the right to review any investment in noncovered areas, such as the cultural industries, whatever its size.

Does the Agreement open up Canada to a flood of foreign takeovers that could be described as "selling out the shop"?

The Agreement grandfathers all existing rules that discriminate against foreign investment. The only thing Canada has given up is the right to review foreign direct takeovers of middle-sized firms.

There is no doubt that this chapter implies some restraint on each country's sovereignty. Supporters of the Agreement argue, however, that in light of Canada's self-interest in establishing rules of fair play on its investment abroad, giving up the seldom-used right to review takeovers of middle-sized firms is a reasonable price to pay for the gains achieved in this chapter.

The increased market that the Agreement allows probably will lead to a burst of new investment, mergers, and takeovers. No doubt Canadian investment in the United States will increase, as will U.S. investment in Canada. This is because many

firms newly expanding from one country into the other country's market need a physical presence there. If the past is any guide, as carefully documented in a recent study by Professor Ed Safarian,[1] neither country will be sold out to the other. All that will happen will be more of the same: the increasing globalization of the investment of all major companies.

Will the Agreement prevent provincial governments from using special tax breaks and other incentives in order to entice industries into locating in their province?

This issue needs careful clarification. Article 1609 allows any new taxation or subsidy as long as it does not constitute a means of arbitrary or unjustifiable discrimination between investors of either country. Insofar as a provincial government can justify such a measure — for example, to "level up the playing field" — it will be allowed, although it might be challenged by the new Canada-U.S. Trade Commission that is to be established under Chapter 18 of the Agreement. Straightforward province-building by granting special privileges and subsidies will be subject to fair trade laws as before. But the Agreement does not hamper such actions unless they are focused on Canadian firms.

Is the investment chapter a one-sided set of Canadian concessions in return for no real gain?

The main purpose of this chapter is to create, in the italicized words of the Agreement, "*a hospitable and secure climate of foreign investment in both countries that is necessary to achieve the full benefit of liberalized trade in goods and services.*" Canada is an important investor country — its stock of investment in the United States is increasing about three times as fast as is the stock of U.S. investment in Canada. It is, therefore, in Canada's own interest to get rules of national treat-

[1]See A.E. Safarian, *The Canada-U.S. Free Trade Agreement and Foreign Direct Investment*, Trade Monitor no. 3 (Toronto: C.D. Howe Institute, 1988).

ment installed before there is any backlash against the rapidly growing stock of foreign investment in the United States. A decade from now, this achievement may turn out to have been one of the most far-sighted measures in the whole Agreement.

Does the investment chapter expose the Canadian petroleum industry to an even greater degree of foreign ownership?

The petroleum industry is fully exempted (in Annex 1607.3). Furthermore, Articles 1602.5 and 1602.6 still allow restrictions on who may purchase firms that are privatized. If Petro-Canada were ever sold to the public, for example, the Agreement would allow the federal government to restrict the purchase of shares to Canadian citizens.

Does the investment chapter prevent future discrimination, in the form of prohibitions or performance requirements, against foreign investment?

The answer to this question is yes. People who wish to be able to discriminate in the future worry about this restriction. Those who recognize the rapid globalization of investment say that it is a concession to the inevitable. It is also on the agenda for the Uruguay Round of GATT negotiations.

Virtually all policies with respect to investment that would be available to a single, closed economy are available under the Agreement. What the Agreement rules out is the power to force different behavior on firms of domestic and foreign nationality. One's concern over this restraint will depend partly on one's views on the extent to which the behavior of firms is influenced by their nationality, rather than by both their institutional structures and the markets in which they operate.

17

Financial Services

Content

The Agreement protects all existing rights and privileges that each country's financial firms enjoy in the other country's market (Articles 1702.4 and 1703.4).

The major changes instituted by the terms of this chapter are the following:

- Canada has agreed to exempt U.S. firms from Canadian ownership laws (Article 1703). These laws limit all nonresident ownership of Canadian financial institutions to 25 percent of total ownership and prevent individual foreign investors from owning more than 10 percent of a Canadian financial institution. (U.S. firms are not exempted from the rule that prevents any individual, or related group of individuals, from owning more than 10 percent of any Canadian chartered bank.)
- Canada can continue to review applications by U.S. firms to establish financial institutions in this country. It has agreed, however, to exempt U.S. firms from the existing 16 percent ceiling on the share of total bank assets that may be owned by foreign banks.
- The United States has agreed to drop its forthcoming review of the existing right of Canadian banks to operate in more than one U.S. state.
- Article 1702 guarantees that Canadian financial institutions will receive the same treatment as that accorded U.S. financial institutions with respect to amendments to the United States' *Glass-Steagall Act.*[1]

[1]The *Glass-Steagall Act*, which governs the relationship between the banking and securities industries, is roughly equivalent to Canada's *Bank Act*. Under this act, commercial banks in the United States cannot be involved

(continued)

With the exception of insurance, dispute settlement resolution in the financial sector will not be handled by the new mechanisms that the Agreement establishes. Instead, all matters and disputes regarding financial services will be dealt with through consultations between the Canadian Department of Finance and the U.S. Department of the Treasury (Article 1704).

Significance

Canadian financial institutions are allowed to operate in a much broader range of financial activities than are their U.S. counterparts. For example, Canadian banks can own securities firms, while the *Glass-Steagall Act* prohibits their U.S. counterparts from doing so. Thus, Americans will enjoy Canada's more relaxed regulations, although they will discover that the highly competitive Canadian market affords less room for exploiting those advantages. The agreement to guarantee Canadian banks and other financial institutions nondiscriminatory treatment under all future amendments to the *Glass-Steagall Act* may prove to be significant, since it is not at all certain that amendments to the act — which could occur soon — will be extended to all comers on a national-treatment basis.

The United States has also agreed to allow Canadian banks, either directly or through their securities subsidiaries, to underwrite and deal in securities issued, or guaranteed, by the Canadian government (Article 1702.1). Without the Agreement, Canadian-owned securities subsidiaries operating in the United States could not underwrite Canadian federal and provincial government securities or those of Crown corporations. Thus, this is a concession of some importance to Canadian banks with newly acquired U.S.-based securities firms, since they will be able to preserve a major portion of the U.S.

[1]Continued . . .
in investment banking. As a result of recent reforms of regulations governing the financial industry, Canadian banks have been allowed such involvement.

operations of their new acquisitions. Since the bulk of the underwriting for Canadian Crown corporations is done in New York, this is a significant gain to Canadian financial institutions.

Concerns

Does the Agreement limit Canada's freedom to use such monetary instruments as the exchange rate?

The Agreement in no way affects the activities of the Bank of Canada. Thus, monetary policy is not restricted. Since flexible exchange rates are the basic adjustment mechanism by which differences in national competitive positions are redressed, it is imperative that the Canadian-U.S. exchange rate be left to be determined in the market, at least during the transition period in which the terms of the Agreement are being implemented.

18

Institutional Provisions[1]

Chapters 18 and 19 cover what are broadly described as dispute settlement mechanisms. Chapter 18 deals with less controversial aspects, while Chapter 19 deals with matters that those who oppose the Agreement have used as a major part of their case for doing so.

Content

The main feature of Chapter 18 is the creation of a Canada-U.S. Trade Commission (Article 1802), empowered to oversee the working of the entire Agreement and to resolve disputes arising from its interpretation and/or implementation. The Commission is to have equal representation from both countries, with the Canadian Minister for International Trade and the U.S. Trade Secretary acting as the principal participants. Any dispute arising out of the general provisions of the Agreement will be directed first to the Commission, which will attempt to arrive at a mutually satisfactory resolution. This is a GATT-like, consensual procedure.

If a dispute cannot be settled within 30 days after being referred to the Commission, an arbitration panel is to be set up consisting of five members, two from each country and one selected by the Commission. The panel can set its own procedural rules (Article 1807), but it will operate under strict time limits. Each country has the right to at least one hearing before the panel, to provide submissions and rebute any arguments. The panel can make binding decisions if the two

[1]For a much more detailed analysis of the provisions of this chapter, see the papers by Debra P. Steger (from a Canadian perspective) and Gary N. Horlick (from a U.S. perspective) in C.D. Howe Institute, *Dispute Settlement in the Canada-U.S. Free Trade Agreement*, Trade Monitor no. 6 (Toronto: C.D. Howe Institute, 1988).

countries agree, or it can simply return recommendations to the Commission, which is then mandated to agree on a resolution of the dispute.

The institutional provisions also deal with disputes arising from any emergency actions allowed for in Chapter 11 of the Agreement. Any such dispute that cannot be resolved by the Commission will be subject to compulsory binding arbitration (Article 1806).

If either country adopts a measure that might materially affect the functioning of the Agreement, the other country must be notified. There is also an allowance for cabinet-level consultations to head off any possible problems that might arise.

Significance

Problems no doubt will arise as experience develops, but these provisions seem like an excellent beginning. The creation of a cabinet-level committee assures high-level consideration of disputes at the outset. The referral of disputes to a panel that operates on a strict timetable and that can make binding decisions is a distinct improvement over dispute settlement mechanisms in EFTA, the EC, or the GATT.

Concerns

Here again, there are no concerns to discuss. These mechanisms are so reasonable, so obviously better than those now in existence for bilateral disputes, and so obviously superior to those in other regional trade agreements, that critics have ignored this chapter. Indignation at what was not obtained under Chapter 19 has lead to neglect of the substantial achievements embodied in Chapter 18.

19

Binational Dispute Settlement in Antidumping and Countervailing Duty Cases

Content

Chapter 19 embodies the Agreement's provisions on fair trade laws. From the Canadian point of view, the most important of the fair trade laws concern countervailing duties. These are outlined in more detail in Box 7. Some Canadian observers had hoped that Canada could gain total exemption from the U.S. laws. This unrealistic hope was dashed when the terms of the Agreement were published. Nonetheless, the negotiators made substantial progress on the perplexing question of how to constrain fair trade laws to do their job of leveling up the playing field while preventing them from acting as nontariff barriers to trade.

There are two important thrusts to the complex set of obligations proposed to deal with bilateral disputes in antidumping and countervailing duty cases.

First and foremost is the two countries' commitment (in Article 1907) to develop, over a five-to-seven year period, a mutually acceptable set of trade remedy laws (see Box 1 in the Introduction to this study). Once established, these laws will replace the unilateral application of domestic antidumping and countervailing duty rules.

In the meantime, Article 1904 of the Agreement establishes a set of procedures involving both countries in what is called a "binational dispute settlement mechanism". This new mechanism has two roles: to fulfill a legislative watchdog function, and to replace the existing appeals procedure that works through the higher domestic courts.

Box 7

Understanding U.S. Countervail Procedures

Current U.S. trade laws are fully consistent with, and are allowed for, under the internationally agreed rules of the GATT. In the case of countervail, procedures can be taken if three conditions are satisfied: if the offending import received a government subsidy; if the reduction in price and volume of subsidized imports was sufficient to do significant damage to the firms in the importing country (the so-called injury test); and if the subsidies "caused" the injury.

On receiving a complaint from a private interest, the U.S. Department of Commerce and the U.S. International Trade Commission provide what is supposed to be an impartial, technical appraisal of whether or not U.S. trade laws are being violated. At this stage, a preliminary investigation determines if the U.S. industry is being injured, or is likely to be injured, by the import, and decides if a subsidy in fact exists. A preliminary subsidy determination is then issued. A positive ruling calls for the offending party to post a cash deposit or bond for the estimated amount of the subsidy. A negative ruling ends the investigation.

In the case of a positive ruling, the next stage is to arrive at a final determination of whether or not the U.S. industry is "materially" injured or threatened by the import. A positive result here leads to the imposition of a countervailing duty.

After the preliminary determination, negotiations are often undertaken in an attempt to avoid a countervailing duty. If these negotiations are successful, the hearings do not proceed to a final determination. If agreement cannot be reached, the case proceeds to a final determination, which can then be appealed to a higher domestic court of law.

Each country can continue to apply its current antidumping and countervailing duty laws (under Article 1902) until a substitute regime is adopted, and can revise any of these laws if it so desires. The legislative watchdog function provides for bilateral review of any proposed changes in either coun-

try's current regulations. Any new law one country passes must specify the other country explicitly by name or else the law will not apply to that country. Also, all changes must be consistent with the GATT and the Agreement. The affected country can initiate bilateral consultations designed to change the legislation before it is passed and/or approve compensation if agreement on changes cannot be reached (Article 1903).

The other function of the binational dispute settlement mechanism is the operation of a binational review panel to replace domestic judicial review. Each country will continue to apply its domestic trade remedy laws. Under current practices, any appeal against these laws goes to higher courts in the country in question or to the appeal procedures of the GATT (if it is a GATT decision that is being appealed). Under the Agreement, if decisions by the domestic administering authority are challenged, the binational review panel will determine whether or not domestic laws were correctly and fairly applied.

The binational panel is empowered to uphold a final determination if it is found to be sound and consistent with domestic laws. It can also remand decisions back to the investigating authority — in essence, an order for a new, or revised, investigation. When receiving a remanded decision, the administering authority — in the United States, either the Department of Commerce or the International Trade Commission; in Canada, either the Department of National Revenue or the Canadian Import Tribunal — will correct the error and make a new determination. A final decision made by the panel is *binding* on both parties.

The binational panel will be made up of five members, two chosen by each government and the fifth chosen by the four members previously selected, or drawn by lot if they are unable to agree. The new procedures will allow the investigating authority that issued the determination and private parties to make representations before the panel (Articles 1904.07 and 1904.14). The parties are also obliged to invoke panel procedures if requested by citizens of either country. Finally, and

most importantly, the panel will make decisions within strict time limits. Final binding determinations must take no longer than 315 days — a significant improvement over GATT dispute resolution procedures, which can take several years, and over appeals through domestic superior courts, where a reluctant defendant can delay proceedings severely.

The dispute settlement procedures outlined in Chapters 18 and 19 are summarized in the accompanying figure.

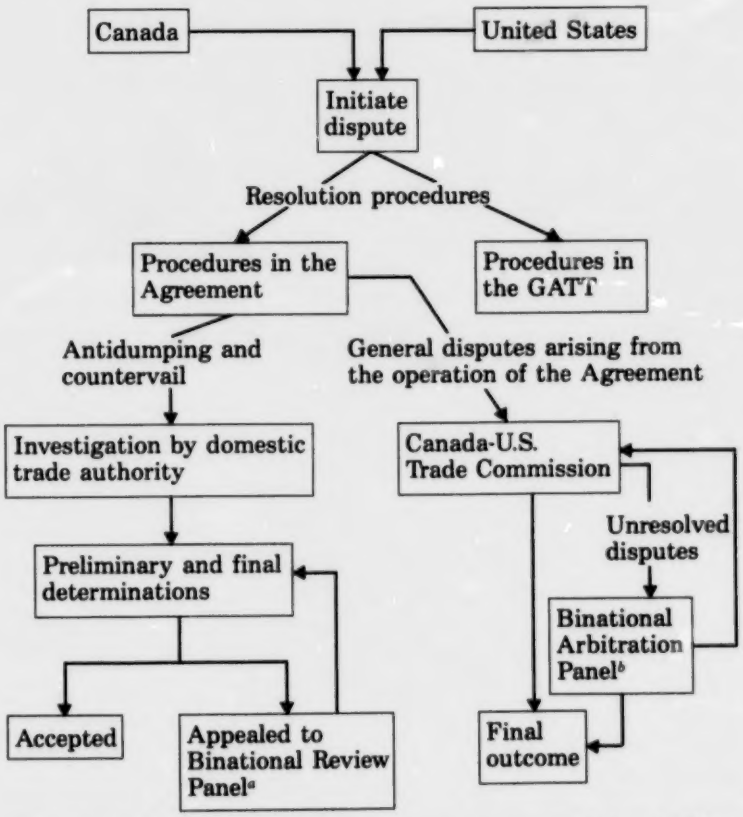
Significance

Recognizing that much will have to await the actual operation of the dispute settlement procedures, the arrangements do look promising and seem to be a clear improvement over the status quo. The watchdog function ends the sideswipe problem, where U.S. measures aimed at other countries inadvertently hit Canada. In the past, a hasty trip to Washington and some heavy special pleading usually have achieved exemption for Canada. No longer will these appeals be needed. The watchdog function also constrains the tactic — often used by protectionists in Congress — of tacking an important amendment onto another bill during a slack period when few legislators are present and no one notices what has been done. The infamous "full-allocated-cost rule" for antidumping — arguably the most restrictive single nontariff barrier in existence today — was passed in this way.

The binational appeal panel for antidumping and countervailing duty decisions should have two major effects. First, it should make U.S. domestic procedures for judging countervail and antidumping disputes more objective. Alan Rugman and Andrew Anderson[1] detail many cases where initial U.S. procedures have fallen well short of the highest standards, and where decisions have been based almost exclusively on evidence presented by U.S. plaintives with little chance for rebuttal by defendants. Under the Agreement, domestic bodies will

[1]Alan M. Rugman and Andrew Anderson, *Administered Protection in America* (New York: Croom Helm, 1987). This paragraph is based on their discussion in Chapter 4, pp. 56–90.

Simplified Representation of Dispute Settlement Procedures



[a]Final determinations are either accepted outright or appealed to the Binational Review Panel. The Binational Review Panel is empowered to uphold a final determination if it is found to be sound and consistent with domestic laws. It can also remand decisions back to the investigating authority for what is, in essence, an order for a new, or revised, investigation. Final decisions by the Panel are binding on both parties.

[b]The Canada-U.S. Trade Commission can resolve disputes, or refer unsettled issues to the Binational Arbitration Panel. The Arbitration Panel can, if requested by both parties, make a binding decision, or simply return recommendations to the Trade Commission, which is then mandated to agree on a solution.

know that their decisions are subject to binational review. This should exert a salutary effect in inducing them to make their investigations more objective.

Second, the binational panel will encourage appeals where the appellant feels there is a strong case to be made. No one is suggesting that the U.S. courts of appeal are politically biased. But their proceedings can stretch over years, particularly if the party defending against the appeal does not wish to expedite matters. In the meantime, the duty must be paid. The uncertainty over the time it might take is a disincentive to resort to appeal, as it was in the softwood lumber case — although the lumber industry and the Canadian government disagreed over whether the disincentive was sufficient to justify not appealing the U.S. decisions. The new procedure's strict timetable is thus a distinct gain.

Concerns

With respect to security of access, is this Agreement better than the available alternative of no agreement?

A typical statement that leads one to pose this question is that Canada gained nothing because the United States will still be able to apply its own fair trade laws to Canada. The second half of this statement is true; the first half is false. Although the Agreement did not achieve the unrealistic goal of complete exemption for Canada from U.S. fair trade laws, to some extent it did achieve the realistic goal of increasing security of access incrementally. This occurred in several ways:

- The binational dispute settlement mechanism for antidumping and countervailing duty cases is, possibly, a small but certainly a clear improvement over the status quo, which has no such mechanism.
- The two countries' obligation to continue negotiating over fair trade laws is valuable. It is hard to see how such a binding commitment could be obtained under the status quo, where

either side can refuse to negotiate at all or can break off negotiations at any time.

- Significant gains on antidumping need not wait for the completion of the full five-to-seven-year negotiating period, since both sides seem to agree now that some current antidumping practices constitute restraint of fair trade.
- It may take a long time to reach a comprehensive agreement on so sensitive a matter as fair trade laws. After all, what Canada and the United States negotiated in 18 short months is stunning by the standards of all past international experience.

On this last point, some people have criticized the five-to-seven-year period allowed for the two countries to arrive at a new set of laws governing trade practices. In the opinion of many trade experts, however, solid gains on antidumping — such as removal of the full-allocated-cost rule — are possible in a shorter period.

On subsidies, a five-year period may be needed for research to be completed and its results to be disseminated. As we noted in the Introduction, this will be part of the long education process to persuade Americans of the extent to which their country really does subsidize, and to persuade Canadians that they can give up some of their current addiction to subsidies without giving up their ability to achieve legitimate national goals. Many Canadians seem to feel that a subsidies code is merely a license for Canada to subsidize in all of its old ways. In fact, any agreed subsidies code probably will impose a severe restraint on many Canadian subsidy practices. For example, if the draft subsidies code had become part of the Agreement, we strongly suspect that the very people who now oppose the Agreement because it contains no subsidies code would have been even more vehement in their opposition because of what the draft subsidies code contained.

Isn't the GATT's dispute settlement mechanism just as good as that set up under the Agreement?

To answer this question in the affirmative is to misunderstand U.S. antidumping and countervailing laws. The key point is that although U.S. fair trade laws are consistent with the GATT code, Canada's current problems arise from the way in which the United States administers these laws. In the case of countervail decisions, the alternative to the mechanism that the Agreement sets up is to appeal through the U.S. legal system. We have already observed that this is often very costly because of the time involved.

Will the new dispute settlement mechanism hinder Canada's chances of appealing disputes to the GATT?

The answer is no. Disputes arising from the Agreement or from the GATT may be settled in either forum, according to the rules of that forum. Once a dispute is directed along one channel, however, the use of the other is necessarily precluded. This is standard in any legal situation. If two appeal routes are available, the appellant must choose one or the other, not both. Bilateral disputes very likely will be handled more efficiently under the new mechanism. After all, GATT procedures are initiated only after most of the injury to domestic producers is done, and only at the end of a long and cumbersome process.

Is it not true that the new dispute settlement mechanism only kicks in at the end of a trade dispute, and that it still compels Canadians to go through the expensive and cumbersome process of tackling these cases through the U.S. injury determination process?

This is true in antidumping and countervailing cases. The new mechanism becomes relevant only at the end of a trade dispute, and only in the event that either party appeals a final determination. This is the same process as used in the

GATT. There is some gain, however, in that disputes may be headed off through the notification and consultation procedures required before any actions are taken. Unlike the GATT's procedures, the Agreement allows matters to be resolved even before referral to the dispute settlement mechanism. Furthermore, private citizens will not have to be burdened by the cost of pursuing an appeal to a final determination, since governments will now initiate procedures and incur the expenses.

20

Other Provisions

Content

The innocuous title of this chapter conceals at least one very contentious issue, mixed in with some quite routine matters.

Article 2002 permits the two countries to restrict capital movements in order to prevent a deterioration of their balance of payments positions. Basically, this provision affirms the two countries' rights and obligations under the GATT, the International Monetary Fund, and the 1961 OECD code on capital movements. Article 2003 allows each country to override the Agreement for reasons of national security and to fulfill United Nations peace and security obligations. Article 2005.1 exempts cultural industries, broadly defined, from the provisions of the Agreement. Article 2005.2 allows the United States to retaliate against Canadian cultural policies. Article 2006 allows each country to be remunerated for the retransmission of radio and T.V. signals.

Article 2010 allows either country to establish a monopoly, provided:

- that the other country is notified;
- that consultations occur if the other country requests them; and
- that an effort is made to minimize the negative effects of the monopoly on the benefits derived from the Agreement.

Designated monopolies must not engage in discriminatory sales contrary to the purposes of the Agreement, or engage in practices — such as predatory behavior or cross subsidization — that harm the other country.

Article 2011 deals with "nullification and impairment", and simply reflects GATT Article XXIII — no more no less. It says that if the actions of one country nullify or impair any benefit that could reasonably be expected to accrue to the other *from the Agreement*, the injured party can invoke consultation or insist on involving the Agreement's dispute settlement mechanism. (This provision does not apply to disputes involving countervailing duties and antidumping, or cultural industries defined by Article 2005.)

Significance

Article 2006 ends the dubious Canadian practice of taking a U.S. television signal for retransmission on cable T.V., substituting Canadian commercials for U.S. ones, and then paying no fee to the originators of the signal. This change is a desirable step in the direction of establishing rules of international copyright, which is in the interests of all countries.

Article 2011 is a standard safeguard against devious attempts to get around some of the terms of any treaty. The main intent of this provision is to provide an avenue for complaint and resolution where the actions of one country have nullified or impaired a benefit that the other country could reasonably have expected to get under the Agreement.

Much of the debate over this chapter has centered around the exemption granted to the cultural industries. In Box 8, we present our best understanding of the concerns people in the cultural community have about the two paragraphs of Article 2005, which is all the Agreement has to say about this sector. Article 2005.1 is clear enough. It exempts *all* cultural industries from the provisions of the Agreement (except for a few specific amendments in policies, which we have already described). The major concerns arise, however, over Article 2005.2, which is worth quoting in full.

Box 8

Concerns of the Cultural Community

The case that Canada's cultural community has made against the Agreement seems to involve the following points.

1. U.S. arts and culture — television, movies, books, magazines — already dominate the Canadian market.
2. Over the years, Canada has employed a number of policies — some of them discriminatory against the United States — to preserve and support Canadian culture. That culture, nevertheless, remains fragile.
3. In spite of protests by foreign governments, particularly the United States, Canada has developed an array of policies that favor Canadian culture. No country has subsequently retaliated in a way harmful to the Canadian cultural community.
4. In future, U.S. interests will be able to use the Agreement *against Canada* in ways that constrain this country's ability to adopt discriminatory policies — film distribution is the best current example.
5. If the United States should retaliate under the terms of the Agreement, it may do so against noncultural industries, which could erode support for culture.

In total, this argument — whatever its flaws — expresses a set of widely asserted and deeply held beliefs of the Canadian cultural community. Points (1) and (3) seem not to be in dispute, but since the Agreement grandfathers most past discriminatory cultural policies, it has no bearing on them. The debt that Canadian culture owes to those cultural support programs which interfere with free trade is, however, in dispute.

As for the future, Canada has acknowledged in the Agreement its legal obligation to compensate the United States for future

> Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent

Box 8 - continued

cultural policies that discriminate against, and commercially injure, U.S. residents. The United States has always had the option of retaliating against Canada for such discrimination — indeed, it has taken such action in the past. Enshrining this right in the Agreement, however, makes it more visible and enforceable. In that sense, this is a significant, if modest, change in the status quo.

The most important question the Agreement raises seems to be: should Canada's cultural community, and the general public, be concerned about formally acknowledging a right the United States already had?

The argument for answering no to this question is that Canada is still able to promote its cultural objectives without adopting discriminatory policies. The Agreement does not rule out preferential tax treatment and/or direct subsidies to Canadian artists or to Canadian cultural industries generally. It does not affect Canadian-content regulations for radio and television, although, in any free society, such regulations should be applied with prudence. It does not affect favorable tax treatment of personal or corporate cultural donations. Thus, there is no reason why Canadian culture cannot be even more generously promoted after the Agreement is implemented than it has been in the past. It certainly seems excessive to argue that Canada's culture has been traded away by an Agreement that preserves full policy independence, while only making explicit an already-existing U.S. right to retaliation.

What the Agreement does is to constrain — by the explicit threat of retaliation — the use of certain policy instruments. Canada can still use these policy instruments, and accept the risk of retaliation. More importantly, however, there are alternative instruments that Canada can use to meet any stated cultural support goal and that do not conflict with free trade.

> with this Agreement but for paragraph 1 [which exempts the cultural industries].

Taken together, Articles 2005.1 and 2005.2 mean that the Agreement leaves Canada free to follow any cultural policy

it wishes, while the United States can retaliate against any such policy that the Agreement would have ruled out had the cultural industries not been exempted.

Concerns

Does the retaliation clause, Article 2005.2 quoted above, put Canadian cultural policies at serious risk and, in effect, nullify the exemption for such policies that is granted under Article 2005.1?

This is a serious worry, expressed by many commentators. Some even worry that the Agreement spells the end of Canadian culture because it implies that Canada can no longer pursue cultural policies. Others feel that Canadian culture is stronger than the specific policies that support it. Be that as it may, what are the Agreement's actual implications for Canada's ability to operate its own cultural policies? A number of points need to be made.

First, notice that regardless of the existence of Article 2005, the Agreement does not affect any cultural support policy that does not conflict with free trade. Governments can continue to subsidize sports, music, ballet, the publication of Canadian authors, and all other cultural activities. Governments the world over follow such policies, in spite of membership in regional trade-liberalizing arrangements. The reason is that none of these policies affects the freedom of trade.

Second, notice that the cultural exemption under Article 2005.1 does have real effect. If that clause did not exist, the cultural industries would be subject to all of the national treatment obligations — with respect to both their investment and their day-to-day operations — that the Agreement imposes on the industries it does cover. The exemption granted under Article 2005.1 means that Canada can continue to discriminate between Canadian and U.S. firms in all existing cultural policies. This was a significant concession by the United States, and it met Canada's demand that the cultural industries be exempted from the Agreement's obligations.

Third, the retaliation clause seems to do no more than to formalize the status quo. In the past, the United States has retaliated against new Canadian cultural policies that injured its interests. Consider, for example, Bill C-58, which stopped Canadian firms from claiming their advertising expenses on U.S. border radio and T.V. stations as tax deductions. When passed in 1976, this measure caused a storm of protest in the United States. For years, the U.S. government tried to get Canada to change its policy. When these efforts failed, it passed mirror legislation in 1984, stopping U.S. firms from claiming their advertising expenses on Canadian border radio and T.V. stations as tax deductions. In other words, having failed to persuade Canada to change its policy, the United States retaliated to equivalent commercial effect.

This case illustrates that the United States has always reserved the right to retaliate in kind against Canadian cultural policies (or any other policies for that matter) that hurt its interests. All the Agreement does is to state this right in the context of the exemption of the cultural industries from the obligations it imposes on other industries. It seems excessive, therefore, to say that the Agreement places severe constraints on Canadian cultural policies. Instead, it seems to leave them exactly where they are now, and where they would be if the Agreement were rejected: Canada can institute any cultural policy it wishes, but if that policy violates the principle of national treatment, the United States can retaliate to equivalent commercial effect.

Fourth, note that the Agreement brings into play a new dispute settlement mechanism. Under the status quo, the United States is the sole judge of the extent to which some new Canadian cultural policy hurts its interests, and of what constitutes equivalent commercial effect. Under the Agreement, Canada can appeal a U.S. retaliatory action by arguing that the harm done is smaller than the United States has assessed it to be and/or that the effect of the U.S. retaliation is greater than the United States has asserted it to be. At worst, the result of such an appeal will be the same as under the status

quo. At best, the appeal procedure will restrain U.S. retaliation to a reasonable level.

Fifth, when one looks at the situation from the United States' point of view, no outcome more favorable to Canada seems possible. Surely Canada never would have agreed to allow the United States to adopt a policy that upset the Agreement without reserving the right to retaliate. Canada's demand that its cultural policies be exempted was reasonable, if strong. It would have been unreasonable for Canada to have demanded that the United States accept any damage done by these policies without having the right to retaliate — and Canada never would, or should, agree to such a demand if put forward by the United States with respect to some other industry.

So the Agreement seems to preserve Canadian cultural policies. Just as under the status quo, however, Canada must examine the implications of instituting some new measure that discriminates against foreign firms in the cultural industries. It certainly can adopt the measure, but it must ask if the benefits would be worth the possible cost of "equivalent-effect" U.S. retaliation.

Does the Agreement prevent the federal or provincial governments from nationalizing any industry?

As Article 2010 spells out, the Agreement does not prevent nationalization. For example, there is nothing to prevent Ontario from adopting a public insurance scheme such as those already in existence in British Columbia, Manitoba, and Saskatchewan. A province or the federal government can also confer a monopoly on a Crown corporation. All of the conditions outlined earlier are reasonable safeguards that allow for a public or private monopoly, provided the monopoly does not abuse its power in either its set-up or its operation. It is also true, however, that if an industry is monopolized, compensation might have to be paid if the monopoly denies benefits to the other party. Opponents of the Agreement worry about the loss of Canada's ability to take over foreign firms without

compensation. Supporters argue that it is in Canada's self-interest — as a major foreign investor — to extend the rule of law to cover government takeovers of foreign investments.

Can Article 2011, on nullification and impairment, be used to gain concessions that the Agreement does not otherwise allow?

Opponents of the Agreement commonly allege that this is so. Many of their arguments turn on the belief that this clause can be invoked under almost all circumstances. For example, some people have argued seriously that this clause is the loophole through which U.S. child-care chains will slip into Canada, where they are not wanted. This worry is unfounded. Article 2011 clearly states that it covers only *benefits that could reasonably be expected to follow from the Agreement*. Since child care is one of the many activities excluded from the Agreement, there is no reasonable expectation of benefits that originate in Canada and go to U.S. child-care firms. Such firms thus have no conceivable recourse to this clause. In any case, Article 2011 refers only to government actions; firms or individuals cannot use it as a route to compensation.

Did Canada bargain away some policies, such as the proposed revisions to the film distribution laws, that were under consideration before the negotiations began?

No one but the negotiators can be sure of what went on behind the closed doors of the bargaining room. However, there is nothing in the Agreement to prevent Canada from adopting any policy it wishes with respect to film distribution or any other cultural industry. When first revealed, Canada's proposed revisions to its film distribution policies did indeed arouse a storm of protest in the United States. If these proposals resurface, they will no doubt rekindle that protest, *whether or not the Agreement is ratified*. Some form of U.S. retaliation is also likely, with or without the Agreement. Whether the existence of the Agreement will induce Canada to hold off on its film distribution proposals is hard to tell.

Certainly, there are pressures on both governments to avoid going forward with contentious issues until the Agreement is in place.

21

Final Provisions

Content

This final chapter of the Agreement provides for the exchange of statistical information and the publication of documents relating to the Agreement. It also allows the two countries to modify or add to the Agreement by mutual consent (Article 2104). Article 2105 states that the Agreement will come into force on January 1, 1989 — provided, of course, that it has been ratified in Parliament and the Congress. Article 2106 allows either country to terminate the Agreement on six month's notice.

Concerns

Will the threat of abrogation of the Agreement allow the United States to hold Canada to ransom?

There is no question that once the Agreement has been fully implemented, Canada would lose more than the United States from its abrogation. We doubt, however, that the United States would risk the loss of credibility that would be entailed by its using the threat of abrogation to extract concessions from Canada. Note also that once the Agreement is in effect, powerful vested interests would be created in the United States that would strenuously oppose abrogation. Everyone must, however, assess the seriousness of this risk for himself.

Conclusion

Canada is a small open economy, highly dependent on exports, which has to compete in a rapidly changing world. For Canadians, the challenge will be to keep up with change or, like all too many countries, fall behind. As technological changes forge new products and new markets, centers of manufacturing are shifting, and trading and investment patterns are adjusting accordingly. Globalization is the name of the new economic game.

Change can be disturbing, because it heralds a new operating environment. Decisionmakers in business and government often need time to adapt to new circumstances. The evidence of history is clear, however, that a country which does not respond to change faces trouble. Against this background, Canadians should recognize the importance of the initiatives being taken in the Canada-U.S. Free Trade Agreement and the current round of multilateral GATT negotiations. These initiatives will help Canada to meet the challenges of the 1990s and, indeed, those of the twenty-first century.

Canada and Trade Liberalization

The Free Trade Agreement nearly completes the program Canada put in place in 1935, when it began to turn its back on the protectionist policy established in 1879 by the government of Sir John A. Macdonald. Since 1935, successive rounds of bilateral negotiations with the United States and multilateral negotiations through the GATT have lowered Canadian tariffs significantly. The Agreement will eliminate most of the remaining trade restrictions.

The main object of the Agreement is to liberalize trade between Canada and the United States, the world's two greatest trading partners. Some people oppose such a liberalization, arguing, for example, that the adjustment costs will be too

high or that particular groups will be hit too hard. The assessment we have presented here is not written from this perspective. Instead, we have looked at the Agreement as a vehicle for liberalizing bilateral trade, with the expectation that this is required to ensure Canada's future prosperity as a trading nation.

The Agreement greatly increases Canadian exporters' *access* to the U.S. market, a move which a large majority of Canadian businesses welcome. The measures that increase access run from the almost complete elimination of tariff barriers to the removal of the most obvious nontariff barriers, such as arbitrary standards levied against foreign products.

The Agreement also increases Canadian exporters' *security of access* to the U.S. market through a wide variety of measures, including the severe restrictions placed on emergency actions used to restrict imports that surge unexpectedly.

Finally, the Agreement promises to produce *future increases in security of access* by mandating negotiations on revision of trade remedy laws.

The GATT Is Not an Alternative

This Agreement should not be regarded in isolation, but as part of a comprehensive set of trade strategies. There is no way that Canada could obtain through the Uruguay Round of GATT negotiations all of the gains in access that the Agreement offers. Any tariff reductions negotiated through the GATT must be extended on a most-favored-nation basis to all other GATT members, and it is inconceivable that Canada or the United States would be willing to extend the tariff reductions the Agreement contains to all other countries. Many trading countries likely would not accept measures that increase security of access, such as the containment of emergency action, which the Agreement contains. Finally, the United States is unlikely to subject its domestic decisions on antidumping and countervailing duties to binding review by a multinational GATT panel.

The Agreement is pathbreaking in its liberalization of trade in a range of sectors, from agriculture to services. Other regional trade-liberalizing arrangements have yet to address these topics adequately.

Compared with what has been accomplished in the GATT, the EC, and EFTA, the Agreement goes a long way toward providing Canadian exporters with security of access to the U.S. market. To argue that the Agreement should be rejected because it does not provide even more security of access, no matter how desirable that might be, is to make the best be the enemy of the good. Together, however, the Agreement and the Uruguay Round of GATT negotiations promise to provide a really significant increase in access to foreign markets for Canadian exporters.

Should the Agreement Be Rejected?

The status quo — with its existing barriers to firms wishing to serve the combined markets of the two countries from a Canadian location, and continuing U.S. pressures toward further protectionism — fares poorly when compared with the Agreement's achievements on market access. The Agreement goes further and deeper on access than any other trade-liberalizing arrangement in the world today. The Agreement also seems to be better than any other bilateral treaty the two countries could ever negotiate if this one were to be rejected. For example, all of the protectionist interests in the United States that are now beginning to oppose this Agreement would be mobilized fully to make their influence felt during the negotiating stage of any other agreement — assuming that the United States was interested in negotiating at all.

The case for rejecting the Agreement, therefore, must lie in the argument that Canada gave up too much outside of the sphere of trade liberalization to justify the real gains it stands to obtain by liberalizing trade. To assess this case, one needs to look at what the two countries did and did not give up in the Agreement. Much of the problem in doing so lies in iden-

tifying myths about sacrifices that some people allege the Agreement entails but that are not in fact required.

What Canada Has Given Up

On nontariff issues, here is what Canada appears to be giving up if it accepts the Agreement.

- Canada will no longer demand performance requirements of U.S. firms investing in this country. Insofar as they relate to exports and imports, these requirements are not consistent with Canada's GATT obligations in any case. Insofar as they relate to other matters, Canada's giving them up is a clear restraint on future policy. The importance of this restraint depends on how one views the international investment scene of the future. Those people who mistrust foreign capital wish to retain the right to impose such requirements. Others hold that the nationality of firms' owners is irrelevant to their behavior and that, although rules and regulations may be needed to control behavior, these rules need not distinguish between domestic and foreign firms. In any case, so these people argue, in the present globalized economy, it is unrealistic to expect foreign firms to accept restrictions on their behavior of the sort that they accepted in the 1950s and 1960s.

- Canada gives up the right to review all indirect takeovers, and direct takeovers worth between $5 million and $150 million. In return, it obtains an exemption from any review of foreign investment that the United States may introduce after the Agreement is in place. The world economy has become intensely internationalized, and investment flows are a key part of this development. At most, the discouraging effect of reviewing direct takeovers of this magnitude would be marginal on these flows. Even if future reviews are as fierce as they were at the height of the activities of the Foreign Investment Review Agency in the 1970s, they will have only a

marginal effect on the ownership of this country. To say, therefore, that this aspect of the Agreement constitutes a sellout of Canada to the United States seems a bit excessive.

• Canada gives up the right to levy export taxes on energy or to discriminate on purely nationalistic grounds between prices charged Canadian and U.S. buyers of Canadian energy. (Canadian firms can still charge different prices under different market circumstances.) Enough tools remain in the policy kit, however, to adopt any resource policies except those whose explicit object is to distinguish among energy producers or energy consumers on the basis of their nationality. Canada can, for example, tax resource rents, control the rate of extraction of nonrenewable resources, and adopt measures to encourage the exploration of new resources.

What the United States Has Given Up

Finally, let us look at what the United States has given up by way of sovereignty. Here are just a few examples. The binational review of each country's final determinations on antidumping and countervailing duty cases is an historic concession on the part of the United States, which has long been reluctant to have its national decisions subject to international review. Although review takes place in the GATT, it lacks effective means of enforcement. The Agreement allows the binational review panel to pass judgment on the application of U.S. laws. Many trade lawyers feel that this will have a salutary effect on the way in which the United States administers these laws, and on the decisions that it takes.

As a result of Articles 407, 1101, and 1102 of the Agreement, the United States will no longer be able to use the threat of quantitative restrictions to pressure other countries into agreeing to voluntary export restraints. Since the United States has made frequent use of this policy tool in recent years,

albeit rarely against Canada, this will probably be a significant restraint on U.S. actions.

Article 907 prevents the United States from cutting off Canada's access to U.S. energy markets on national security grounds, short of a genuine shooting war. Again, the United States has done this to other countries in the past, on rather flimsy grounds, and so this, too, is a major constraint on its sovereignty.

Articles 1101 and 1102, which limit the United States' right to take bilateral and global emergency actions against Canada, are another major constraint on U.S. policies that have operated frequently in the past — for example, against Canadian shakes and shingles. The circumstances under which the United States can take emergency action against Canadian imports are greatly constrained, and the amount by which these imports can be affected by such measures is much diminished over what it was in the past.

Finally, by agreeing to national treatment in investment, the United States effectively has tied its hands with regard to hostile policies directed at Canadian foreign investment — policies that may become attractive in the 1990s when Americans are likely to become increasingly concerned over their growing foreign ownership problem, in the same way that Canadians did in the 1970s.

The Balance

The net balance between what Canada has given up and what the United States has given up will be debated for a long time. The result may be a modest balance in either direction — *perfect* balances are rarely, if ever, struck in any bargaining process. Such calculations must be put in perspective, however, by understanding that most of the Agreement is win/win for both countries. If both win, say, 100 points on mutually beneficial gains, it is irrelevant to argue over which country got, say, 5 net points on nontrade concessions and then to accept or reject the Agreement on that basis. Opponents,

of course, feel that the net balance on nontrade items is large. Our tour through the Agreement does not tend to support this charge.

Canada is being buffeted by global changes. This Agreement is one part — albeit a key one — of Canada's reactions. Much more than just the Agreement is needed, however. Enlightened policies concerning science, education, and industrial change are also required if Canada is not to fall irretrievably behind in global competition. If the Agreement turns Canadian policy outward, it will have done its job, irrespective of the specific gains that it undoubtedly achieves. To reject the Agreement is to give up major gains in market access and to risk turning Canadian policies in the wrong direction — away from accepting globalization and toward the now-obsolete inward-looking policies of the 1970s.

Appendix: Indirect Constraints on Sovereignty[1]

Indirect constraints on sovereignty arise from economic forces set loose by the Agreement. Some opponents of the Agreement seriously allege that these forces will constrain Canadian sovereignty in ways not legally called for by the articles of the Agreement itself. They will do this by forcing Canada to harmonize its policies with those of the United States — hence the term "harmonizing pressures".

Some of the strongest arguments for rejecting the Agreement depend on alleged harmonization pressures. Almost daily, one hears that Canada will be forced to remove any social or economic policies that are more costly than those in the United States. If this is not done, say the critics, Canadian costs will be raised above those in the United States. Canadian firms will then not be able to compete and will leave for lower-cost sites south of the border, and many of Canada's best people will follow.

This harmonization argument has little support from the experience of other countries, from Canada's own past experience, or from economic theory. Consider the following points.

First, 71 countries — including all the advanced industrial countries except Japan and Canada — are currently in regional trade-liberalizing arrangements. None has complained of lost policy independence. For example, the Netherlands maintains an expensive set of social policies, yet it has been in a free trade area with low-spending Belgium for 50 years. Sweden also has many high-cost social policies — indeed, many more than does Canada — yet this little country of 8 million people trades

[1]The Appendix is based on Richard G. Lipsey, "Sovereignty: Culturally, Economically, and Socially," in John Crispo, ed., *Free Trade: The Real Story* (Toronto: Gage, 1988), pp. 148-160.

tariff free with such economic heavyweights as West Germany and France. Throughout history, rich countries have traded profitably with poor countries, and high-spending countries have traded profitably with low-spending countries. The evidence from other countries is clear: *free trade is not the enemy of diversity in social policy.*

Second, the Agreement comes close to completing a program started in 1935, when Canada slowly began to reduce its high tariffs. By 1986, more than three-quarters of the tariff protection that Canadian industry received in 1935 had been removed. In the meantime, Canadian social and economic policies evolved along lines different from those in the United States. If it is true that liberalizing trade causes policy harmonization, then Canadian and U.S. policies should have been 80 percent harmonized already. The evidence from Canadian history is clear: *Canada can establish, and maintain, its own distinctive social policies, while liberalizing its trading arrangements with other countries.*

Third, strong harmonizing pressures always exist on the social and economic policies of any two countries between which labor and capital can move. If tax rates in Canada exceed those in the United States, some Canadian citizens, and firms, may be induced to move to that country. *Note, however, that these incentives exist whether or not free trade exists.* Many Britons have emigrated to the United States to escape high U.K. taxes, in spite of the high tariffs on U.K.-U.S. trade. Similarly, taxes that hold firms' profits below what they can earn in other countries provide an incentive for them to emigrate, *whether tariffs are high or low.* Ontario should worry, for example, that its social legislation is adding unreasonably to the costs of doing business in that province. There is little evidence, however, that the changes contained in the Agreement will have more than a small effect one way or the other on these harmonizing pressures — numerous comments to the contrary notwithstanding. The evidence from experience and theory is clear: *strong harmonizing pressures between Canada and the United States do exist, but they are related mainly to the ease*

with which people and firms can relocate — which the Agreement does not alter — rather than the ease with which goods and services can be traded — which the Agreement does alter.

Fourth, any broadly based social policy that increases business costs across the board, as does Canada's unemployment insurance, brings into play a compensating change in the exchange rate. For example, if the federal government wished to introduce a new measure that would raise all Canadian business costs by 10 percent, this would not destroy the competitive position of Canadian exporters. Instead, it would tend to reduce the external value of the Canadian dollar by 10 percent, leaving international competitiveness unchanged. The theoretical explanation is clear: *the exchange rate provides the key mechanism that allows the diverse social policies that are found among today's trading countries to coexist.*

But, argue some of the critics, Canada is different from all other countries and no other country's experience is relevant to Canada's situation. It seems odd that many of the same critics also feel that the two peoples are so similar that Canadians will become Americans if they trade a bit more with them.

These critics worry that Canada's distinctive identity will be lost under free trade. Anyone who has lived in the United States knows that Canadians are not Americans. The reasons for the profound differences between the two peoples lie in their different histories, geographies, and immigrant experiences. Canadians should have enough confidence in themselves to grasp the material advantages that free trade with the United States offers, while understanding that they will remain Canadians even if they eat one more McDonald's hamburger, or watch one more episode of *Dallas* — or trade a bit more with the United States.

Other critics argue that if Canadians do not actually become Americans as a result of free trade, they will catch the United States' alleged lack of dynamism and adopt its gun laws. But consider Canada's past experience. Around 1890, the British economy began a decline that has continued to this day.

Britain remained Canada's most important trading partner throughout the first half of this century, however, without Canadians' having caught the "British disease" or adopting their class system. Markets are where one finds them and are valuable as long as one can sell in them — whatever the underlying dynamism of the buyers. As for the Agreement's leading Canada to adopt the United States' gun laws, as Margaret Atwood recently suggested, it is hard to say anything less strong than "nonsense".

John Donne was right when he said:

> Any man's death diminishes me, because I am involved in mankind; and therefore never send to know for whom the bell tolls; it tolls for thee.

The experience of all humanity is indeed relevant to each person's experience. And the experience of other people, in apparently similar situations, should be taken to be relevant to Canadians, *unless reasoned argument persuades us otherwise.* The onus of proof lies with those who say this Free Trade Agreement will unfold in a dramatically different fashion than has the past history of Canadian tariff reductions, or than have similar pacts elsewhere in the world, none of which has led one country to adopt against its will the social policies or laws of one of its trading partners.

Glossary*

Antidumping. Additional duties imposed by an importing country in instances where imports are priced at less than the "normal" price charged in the exporter's domestic market and are causing material injury to domestic industry in the importing country.

Bilateral trade agreement. A formal or informal agreement involving commerce between two countries.

Binding. The concept of agreeing to maintain a particular tariff level of other trade restriction — that is, binding it against increase or change. In trade negotiations, binding a tariff is considered equivalent to a significant reduction in the level.

Binding arbitration. A concept in dispute settlement where the parties to the dispute agree at the outset to abide by the results of dispute settlement procedures.

Border measures. Tariffs, tariff-related measures, quantitative restrictions, and other restrictive measures that impede the free flow of trade across international borders.

Commercial presence (also called *physical presence*). A trade-in-services concept; the presence that a national of one country must have in another in order to complete a service transaction, such as a branch office staffed by local staff. The concept falls short of right of establishment.

*This Glossary is selected from one prepared by the Canadian government and released with the text of the Canada-U.S. Free Trade Agreement. See Department of External Affairs, *Canada-U.S. Trade Negotiations: Glossary* (Ottawa, 1987).

Common market. A common market goes beyond a customs union by allowing for the free movement of labor and capital among its members. (See also *Customs union.*)

Compensation. The concept that withdrawal or amendment of a previously negotiated or bound concession, such as a tariff increase, change in quota level, or a temporary surtax, requires a new and equivalent concession.

Countervailing duty. Additional duties imposed by the importing country to offset government subsidies in the exporting country, when the subsidized imports cause material injury to domestic industry in the importing country.

Customs duties. See *Tariff.*

Customs union. A group of countries that have eliminated trade barriers among themselves and imposed a common tariff on all goods imported from all other countries.

Dispute settlement. Those institutional provisions in a trade agreement that provide the means by which differences of view between the parties can be settled.

Domestic content requirements. A requirement that firms selling a particular product within a particular country must use, as a certain percentage of their inputs, goods produced within that country — a proposition particularly attractive to the auto industry and its workers.

Dumping. The sale of an imported commodity at a price lower than that at which it is sold within the exporting country or to third countries. Dumping is generally recognized as an unfair trade practice that can disrupt markets and injure producers of competitive products in the importing country.

Duty drawback. Import duties or taxes repaid by a government, in whole or in part, when the imported goods are reexported or used in the manufacture of exported goods.

Duty remission. Import duties or taxes repaid by a government, in whole or in part, to a particular company or industry contingent on exports manufactured in the importing country or similar performance requirements, usually on imports of components, parts, or products to complete a product line.

EC. European Community, comprising, as of January 1, 1986, Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, the United Kingdom, and West Germany.

EFTA. European Free Trade Association, comprising Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

Embargo. A prohibition on exports or imports, with respect to specific products or specific countries. Historically, embargoes have been ordered most frequently in time of war, but they may also be applied for political, economic or sanitary purposes. Embargoes imposed against an individual country by the United Nations — or by any other a group of countries — in an effort to influence its conduct or policies are sometimes called "sanctions".

Emergency action safeguards. A provision in a bilateral or multilateral commercial agreement permitting a signatory country to resort to "temporary" import restraints when imports threaten serious harm to the producers of competitive domestic goods. Such "safeguard" actions help firms and workers adversely affected by a relatively sudden surge of imports to adjust to the rising level of import competition. (See also *Safeguards.*)

Establishment. One of the basic principles that comprise national treatment for investors. Right of establishment involves providing foreign investors the right to establish new businesses on the same basis as nationals.

Excise tax. A selective tax — sometimes called a consumption tax — on certain goods produced within or imported into a country.

Export quotas. Specific restrictions or ceilings imposed by an exporting country on the value or volume of certain exports, designed to protect domestic producers and consumers from temporary shortages of the goods affected or to bolster their prices in world markets.

Export restraints. Quantitative restrictions imposed by exporting countries to limit exports to specified foreign markets, usually pursuant to a formal or informal agreement concluded at the request of importing countries.

Export subsidies. Government payments or other financially quantifiable benefits provided to domestic producers or exporters contingent on the export of their goods and services.

Fair trade laws (also called *trade remedy laws*). A set of domestic laws governing the rules of international trade. These laws allow trade restrictions to be placed on "unfair" competition from foreign exports whenever these exports injure domestic industry.

Free trade area. A cooperative arrangement among two or more countries that agree to remove substantially all tariff and nontariff barriers to trade with each other, while each maintains its differing schedule of tariffs applying to all other countries.

GATT. The General Agreement on Tariffs and Trade (GATT) is a multilateral treaty that delineates rules for international trade. It is subscribed to by 95 countries that together account for more than four-fifths of world trade. The primary objective of the GATT is to liberalize world trade and place it on a secure basis, thereby contributing to global economic growth and development.

Government procurement. Purchases of goods and services by official government agencies. As a nontariff barrier to trade, the term refers to discriminatory purchases from domestic suppliers, even when imported goods are more competitive.

Grandfather clause. A clause that provides that certain existing programs, practices, and policies are exempt from all obligations of the Agreement, unless explicitly included.

Harmonized system. A GATT nomenclature used to classify commodities for tariff purposes and for rules of origin.

Injury. The term used in international commerce to describe the effect on domestic producers of a decline in output, lost sales, a decline in market share, reduced profits and return on investment, reduced capacity utilization, etc., as a result of import competition. A distinction is often made between *serious injury* (required for emergency safeguard measures) and *material injury* (required for antidumping and countervailing duties). Under the GATT, the term refers to the requirement that an industry seeking trade relief establish that it has been hurt by foreign competition. In the United States, a finding of injury has always been required for emergency action safeguards to be applied, and since 1979 for the bulk of antidumping and countervailing duty cases as well.

Investment performance requirements. Special conditions imposed on direct foreign investment by recipient governments, sometimes requiring commitments to export a certain percent-

age of the output, to purchase given supplies locally, or to ensure the employment of a specified percentage of local labor and management.

Liberalization. Reductions in tariffs and other measures that restrict world trade, unilaterally, bilaterally, or multilaterally.

Market access. The availability of a national market to exporting countries — that is, reflecting a government's willingness to permit imports to compete relatively unimpeded with similar domestically produced goods.

Most-favored-nation treatment (MFN). A commitment that a country will extend to another country the lowest tariff rates it applies to any third country. The MFN principle has provided the foundation of the world trading system since the end of World War II. All Contracting Parties to the GATT apply MFN treatment to one another under Article I of that agreement. Exceptions to this basic rule are allowed in the formation of regional trading arrangements, provided certain strict criteria are met. (See also *National treatment.*)

Multilateral agreement. An international compact involving three or more parties. For example, since its establishment in 1947, the GATT has sought to promote trade liberalization through multilateral negotiations.

Multilateral trade negotiations. Seven rounds of multilateral trade negotiations have been held under the auspices of the GATT since 1947. Each round has represented a discrete and lengthy series of interacting bargaining sessions among the participating Contracting Parties in search of mutually beneficial agreements to reduce barriers to world trade. The agreements ultimately reached at the conclusion of each round have became new GATT commitments and thus have amounted to important steps in the evolution of the world trading system.

National treatment. This expression refers to the extension to imported goods and (where applicable) to foreign investors, of treatment no less favorable than that accorded to domestic products and investors with respect to internal taxes, laws, regulations, and requirements.

Nontariff barriers. Government measures or policies, other than tariffs, that restrict or distort international trade. Examples include import quotas, discriminatory government procurement practices, and measures to protect intellectual property.

Producer subsidy equivalents. The direct subsidies required to replace all agricultural support programs while leaving farm income unchanged — that is, the dollar value of all transfers by direct and indirect programs.

Protectionism. The deliberate use or encouragement of restrictions on imports to enable relatively inefficient domestic producers to compete successfully with foreign producers.

Quantitative restrictions. Explicit limits or quotas on the physical amounts of particular commodities that can be imported or exported during a specified time period, usually measured by volume but sometimes by value. The quota may be applied on a "selective" basis, with varying limits set according to the country of origin, or on a quantitative global basis that only specifies the total limit and thus tends to benefit more efficient suppliers. Quotas are frequently administered through a system of licensing.

Quota. A limit to the quantity of a product that may be imported by (or sold to) a country. Import quotas are enforced by the receiving country, export quotas by the country of origin.

Retaliation. Action taken by a country to restrain its imports from a country that has increased a tariff or imposed other measures that adversely affect its exports in a manner inconsistent with free trade. The value of trade affected by such retaliatory measures, in theory, should approximately equal the value affected by the initial import restriction.

Rules of origin. The term for the set of measures used to differentiate between goods originating in one country from those in another for the purpose of applying such trade measures as tariffs. For example, the 50-percent-of-direct-cost rule means that goods having at least 50 percent of the direct cost of manufacturing accounted for in Canada may be considered to be originating in Canada, whereas having only 25 percent would not.

Safeguards. This term refers to emergency actions in the form of additional duties or import quotas applied to fairly traded imports that nevertheless cause or threaten serious injury to domestic producers.

Services. Economic activities that provide services rather than goods. Included are such diverse activities as transportation, communications, insurance, banking, advertising, consulting, distribution, engineering, medicine, and education. Trade in services takes place when a service — such as an international airflight, the extension of credit, or the design of a bridge — is exported from one country to another.

Sideswipe. This is said to occur when one country is affected by another country's trade-restraining (or retaliatory) measures when such measures are specifically aimed at others. For example, Canadian exports to the United States are sideswiped by U.S. actions aimed at limiting Japanese exports, because GATT procedures do not allow specific countries to be exempted from global trade actions.

Standards. Technical specifications contained in a document that lay down such characteristics of a product as levels of quality, performance, safety, or dimensions. They may include, or deal exclusively with, terminology, symbols, testing and test methods, packaging, or marking of labeling requirements as they apply to a product.

Subsidies code. A code of conduct establishing both substantive and procedural standards for national countervailing duty proceedings. The code would clarify just what subsidies would not be subject to countervail duties.

Subsidy. An economic benefit granted by a government to producers of goods, often to strengthen their competitive position. The subsidy may be direct (a cash grant) or indirect (low-interest export credits guaranteed by a government agency, for example).

Surcharge or surtax. A tariff or tax on imports in addition to the existing tariff, often used as an emergency safeguard measure.

Tariff. A duty (or tax) levied on goods transported from one customs area to another. Tariffs raise the prices of imported goods, thus making them less competitive within the market of the importing country. The tariff rate is the rate at which imported goods are taxed.

Tariff schedule. A comprehensive list of the goods that a country imports and the import duties applicable to each product.

Trade liberalization. A general term used to denote the gradual process of removing tariff and nontariff barriers.

Unfair trade. A U.S. term used to describe trade in dumped, subsidized, or counterfeit goods. The application of the term has steadily widened as U.S. trade remedy laws have defined

new practices that are considered to harm the export and import interests of U.S. companies.

Uruguay Round. The eighth in a series of multilateral trade negotiations held under the auspices of the GATT. This round was launched at Punta del Este, Uruguay, in September 1986.

Value added. The value of a firm's output minus the value of the imports that it purchases from other firms.

Voluntary export restraints (VERs). Informal arrangements by which exporters voluntarily restrain certain exports, usually through export quotas, to avoid economic dislocation in an importing country and to avert the possible imposition of mandatory import restrictions. Such arrangements normally do not entail "compensation" for the exporting country.

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McCain Foods Limited
McCallum Hill Companies
MacDonald, Dettwiler & Associates Ltd.
McKinsey & Company
Maclab Enterprises
MacLaren Advertising
James Maclaren Industries Inc.
Maclean-Hunter Limited
McLeod Young Weir Limited
McMillan, Binch
MacMillan Bloedel Limited
J. Stanley McVicar
Magna International Inc.
The Manufacturers Life Insurance Company
Maple Leaf Mills Limited
Georg Marais
Maritime Telegraph & Telephone Company, Limited
The Mercantile and General Reinsurance Company of Canada
Metropolitan Life Insurance Companies
Midland Bank Canada
Les Minoteries Ogilvie Ltée.
Mitsui & Co.
Mobil Oil Canada, Ltd.
The Molson Companies Limited

Montréal Trust Company of Canada
Donald S. Morgan
Morgan Stanley Canada
Murphy Oil Company Ltd.
The Mutual Life Assurance Company of Canada
National Trust Company
Nesbitt Thomson Deacon
William H. Neville & Associates
The New Brunswick Telephone Company, Limited
John Nichol
Louis-Paul Nolet
Noma Industries Limited
Noranda Inc.
Northern Telecom Limited
Northwood Pulp and Timber Limited
NOVA Corporation of Alberta
Ontario Hydro
PCL Industries Limited
PanCanadian Petroleum Limited
Charles Perrault
Petro-Canada Inc.
Phillips Cables Limited
Laurent Picard
Claude Pichette
The Pioneer Group
Les Placements T.A.L. Ltée.
Placer Dome Inc.
Polysar Energy & Chemicals Corporation
Polysar Limited
Portfolio Management Corporation
Power Corporation of Canada
Prairie Pools Inc.
Price Waterhouse & Co.
Procor Limited
ProGas Limited
Provigo Inc.
Publications les Affaires Inc.
Quebec and Ontario Paper Company Limited
Québec-Telephone
Raymond, Chabot, Martin, Paré et Associés
Henri Remmer
Retail Council of Canada
R.T. Riley
Robin Hood Multifoods Inc.
Rogers Communications Inc.
The Royal Bank of Canada
Royal Insurance Company of Canada
Royal LePage Limited
Royal Trust
Roynat Inc.
Sandoz Canada Inc.
Sandwell Swan Wooster Inc.
Guylaine Saucier
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Spar Aerospace Limited
Stelco Inc.
Sun Life Assurance Company of Canada
Suncor Inc.
Swiss Bank Corporation (Canada)
Teck Corporation
Téléglobe Canada
Telesat Canada
Texaco Canada Inc.

Thomson Newspapers Limited
Thorne Ernst & Whinney
3M Canada Inc.
The Toronto-Dominion Bank
Toronto Star Newspaper Limited
The Toronto Stock Exchange
Touche Ross
TransAlta Utilities Corporation
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Trimac
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